INCOME & ASSET ADVISORY INC.
Registered Investment Advisor
Financial Planning and Investment Management

The ADVISORY

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An Overview

In the past four issues of The ADVISORY we have focused on the changes to the system that we now employ in the quest to grow your portfolio, while limiting risk to the capital. Hopefully, we have been able to make the process understandable. (However, just in case we have not been clear we are enclosing a pamphlet that describes how ETFs are both similar and different from managed mutual funds.) In future issues, we will review the daily process, the portfolio construction, and risk management tools that we use in addition to the Trend Tool.

The 4th Quarter 2009 reports were sent out in January, so hopefully you have had an opportunity to review the results. In almost all of the managed accounts, returns were even to slightly negative for the quarter. The primary reason for this was the rising interest rates in the United States and overseas. The Benchmark 10yr. Treasury rose from a low of 3.25 to 3.80 by the end of December. Although we did not own that security, all fixed income securities suffered price declines, which, in turn, reduced the total return. We had made trades during the quarter into GLD (Gold ETF), and PGX (Preferred Stock) both issues rose during the period.

As we moved into the New Year, a complete review of the portfolios was undertaken. The initial premise based on Trend Tool and market action was that equity exposure should be increased in both the Growth and Core Fixed. (The reason for adding a small amount of GLD and PGX to the Core Fixed was to add inflation protection with some opportunities for asset appreciation.)

As the reviews continued we decided to add more inflation protection, more income producing ETFs and, as stated before, an elevated equity exposure. We have sold MBB Mortgage and 50% of LQD to fund these trades. The risk level in MBB has risen as the Fed has announced it will stop purchasing this type of security in March. If that happens, demand will decline, supply will remain constant, so prices will most likely decline. We don't care to expose the portfolio to that risk. As January ends, volatility has returned to the Equity markets. Scott Brown won the Massachusetts Special Election for Ted Kennedy's seat on a platform opposed to all Senator Kennedy supported. Two days later President Obama declared war on the banks, which, combined with other factors, created a 6% reversal in the DOW. China announced they were cutting credit, while Greece, Dubai and other troubled countries continued to struggle.We will make adjustments to the portfolio mix by adding VXX, the Volatility Index, which rises when markets fall. Also, adding a small percentage of UUP, the long US dollar ETF, and possibly IEF, the 7-10 yr. treasury fund as safe havens in times of volatility.We also will put tighter stop/loss protection on the equity positions.

The investment management process has become much more intense since mid 2007. We have added resources in the form of a risk management consultant as well as a great deal of study on the part of our staff. Thus far it has paid off, we will do all we can to improve the portfolio results while limiting risk to principal.

Thank you for your continued trust and confidence.

Major factors influencing our investment decisions in 2010

- Money supply – will the Fed continue to print money or drain liquidity from the system?
- Inflation – when will it become apparent forcing the Fed to raise interest rates 3 months, 6 mos., 1 yr.?
- National Debt – who will buy all the bonds issued by the U.S. and other developed nations?
- Liquidity – the Fed has discussed "how" not "when" it will reduce liquidity.
- Economic Recovery – When will it pick up steam to 3.5% annual growth?
- Unemployment – when will it level off and decline?
- Credit crisis – will banks continue to fail?
- Credit crunch – lack of access to funds continues to put pressure on business, commercial real estate, and REITS, not to mention consumers.
- Bankruptcies – both personal and small business continue to rise, again caused by the credit crunch, unemployment, etc.
- Health care costs – continue to rise.
- Tax increases – abound on both state and federal levels- how high?
- Capital and trade – remain sketchy through 2010.

Positive Factors

- The Fed has begun to discuss pulling back. They could pull off a miracle! Don't hold your breath.
- Trade deficits have declined with manufactuing beginning to show some gains.
- Emerging economies are still growing.
- The dollar has rebounded from its lows
- Treasury auctions continue to be well received (But for how long?).
- U.S. households have been bringing treasury debt in much larger amounts.
- BRIC (Brazil, Russia, India,China) leading the world out of recession.
- States have reverted to Republican centrists in VA, NJ,and MA.
- Metro area county executives have lost their jobs in Nassau, Suffolk and Westchester.
- Most polls show U.S. voters are disillusioned with massive Government intervention.

Negative Factors

- Sovereign Debt, Dubai, U.K., Greece, Spain, all carrying huge debt with no understanding of how it will be paid.
- Unexpected rise in interest rates.
- Inflation – the probability but when?
- Municipal revenues – lower, caused by unemployment, lower RE values.
- Slow growth – the result of rising defaults, unemployment, weak consumer demand.
- "Double dip" recession – the result of all of the above.
- Rising stock markets ready for a pull back (5% 3rd week Jan.).
- Bad debts throughout the global banking system no longer offset with government infusions or liquidity.

Added Value
A Case Study

Present situation: Our client, Jane and her husband, share a home in southern Connecticut. Jane is retired and receiving a monthly pension from her job of 30 years. Her younger husband is self-employed with erratic income and no pension. Jointly they own a house, with rights of survivorship.

Since they are married, they can take advantage of filing jointly for taxes and the unlimited marital deduction for assets. Jane has chosen not to have survivor rights for her pension. At age 66 they will benefit from Social Security and the spousal survivor benefits when one passes on. Jane supplements her pension income with monthly distributions from her IRA, which she rolled over from her 403b when she retired.

Employee benefits: Jane has a good pension that will last as long as she lives. She also has health insurance paid for life through her job. It does not cover her husband.

Current residence: Jane and her husband own the house jointly. The house is valued at $350,000 with an outstanding 30-year mortgage balance of $95,000.

Life insurance: Jane holds a $250,000 life insurance policy on herself to replace the lost pension income at her death.

Investment assets: Jane has a substantial IRA under management with IAA, invested in a diversified bond portfolio.

Planning

Will & Beneficiaries: At Jane's Annual Review, Jim McCauley makes sure that beneficiaries are up to date on her IRA and life insurance. He also asks when Jane's will was last updated and if it reflects her current wishes.

Cash Flow: Jim reviews the sources and amount of income and determines if they satisfy their expense needs. Taking too much income from the IRA increases the taxes owed as well as depleting assets for future needs.

What other sources of income might there be? (Since she is in good health, Jane could work part-time or work with her husband to drum up more business.)

Health Insurance: Jane has little concern about health insurance since her employer continues to pay her premiums. Her husband has enrolled in a catastrophic plan where premiums are low and coverage only occurs once the $5000 deductible is met. However, as they both age, health insurance could be more costly.

LTC (Long Term Care) also will factor in to preserve assets as Jane ages. A disability (e.g. a stroke) could deplete her IRA rapidly if she were confined to a nursing home for an extended period. With Jane already older and of retirement age and cash flow tight, it will be a challenge to find the income to fund the considerable expense of an LTC policy.

During the Annual Review, Jane mentions that she is the beneficiary of an IRA from her brother. It is currently held at his pension company and she needs assistance in rolling the funds into an IRA in her name. Jim's staff makes the necessary inquiries and the transfer forms are on their way. Jim determines that the required annual distributions from this account can be used to fund the LTC premiums.

Jim also recommends that Jane and her husband visit their attorney to prepare a durable power of attorney, a living will, and a health care proxy.

Jane leaves the meeting feeling assured that her financial house is in order and that she and her husband have a secure retirement in place.

*Please note this is a hypothetical example used for illustration only and does not represent any real client.

Meet the Staff

Joe Arcuni has been a part of Income & Asset Advisory, Inc. (IAA) since 1994 and is our resident tech expert. He has many responsibilities, including preparation of clients' Portfolio Reports. Joe's friendly personality and enthusiasm for New York sports are essential elements within our intimate business setting. Currently Joe is studying for a Series 7 license to become a financial representative.

Mary Tedesco has recently joined us as. Prior to joining IAA, Mary was affiliated with a company specializing in insurance needs for seniors. She brings her experience in Medicare Supplements, Medicare Advantage Plans, and Medicare/Medicaid to our firm and to our clients. Mary soon will be taking the Series 6 Exam.

Theresa De Rosa began working at Income & Asset Advisory in 2006. Her responsibilities include: client correspondence, the preparation and processing of various retirement account applications, and transfer paperwork. She also does a great job at making us laugh while keeping our office organized and compliant. Theresa plans to become a certified Financial Support Specialist at Westchester Community College in the near future. When out of the office, she is home spending quality time with her husband, their beautiful baby girl and the family dog Max!

The Advisory
is written by James P. McCauley, Jr. and staff
and is published by
Income & Asset Advisory, Inc.,
80 Business Park Drive,
Armonk, NY 10504
(914) 273-6800 FAX (914) 273-6806
e-mail jim@theadvisory.com

Meet the Staff

Eileen Hawe, an Investment Advisor Representative, has been with IAA for over three years. She brings 25 years of experience having worked at TIAA-CREF, Dean Witter and Merrill Lynch. She focuses on our 403b clients, investments and retirement planning. Eileen has three married children and six grand children.

Bryna Ortiz is IAA's office manager. Bryna focuses on maintaining client relationships, individual portfolio analysis reports, proposals and in-house compliance. She is the point of contact on 401ks and currently is studying for the Series 7 exam. Bryna is married with three boys.

Michelle Rudolph has been working at Income & Asset Advisory since January of 2007. She is currently a senior at Manhattanville College. Michelle processes a variety of paperwork and specializes in 403B administration. Michelle handles technological issues and helps to maintain high levels of organization.

During the final editing of this issue in the first week of February, the equity markets took a precipitous downturn. Several of the Stop/loss orders were exercised: SPY, EFA, EMB, GLD in the Growth Portfolio and HYG, EMB, BWX, GLD in the Core Fixed Portfolio. Most were exercised on 2/3 and 2/4. Although none of us are pleased by the whipsaw effect, it is better to be out of danger and in the safe haven of cash than at risk.

Although the major indexes rebounded later on 2/5 there is no way to know how far they might have dropped. We will allow trades to clear and then determine how to reallocate the funds.

A special "thank you" to all who contributed to ECAD, it is greatly appreciated!

Estate Planning:Part II

Revocable Living Trust

Often we have heard the terms ***revocable trust*** and ***irrevocable trust***. In Part II of our Estate Planning series we will define a revocable living trust, when it should be used, and describe its benefits.

How do you determine if one is right for you? Neither your level of wealth nor your circumstances would be the sole determinants. All levels of wealth and many different situations influence the usefulness of a revocable living trust.

What is a revocable living trust?

A **trust** is a written agreement that names someone to be responsible for managing property for the benefit of others. One type of trust is a revocable living trust. It is a "living" trust because you create it while you are alive. It is "revocable" because, as long as you are mentally competent, you can change or end the trust at any time, for any reason. It becomes irrevocable (cannot be changed) when you die.

Essentially, there are *three parts* to a trust:

1. The person who creates the trust, the grantor (you).

2. The person who agrees to accept your assets (money, real estate, possessions, etc.) and manage them as the trust agreement directs is the **trustee.** More than one trustee can be named, thus creating **co-trustees** who must act together.

3. Those who will receive the income and, eventually the assets from the trust are the **beneficiaries.**

Let us examine each part:

Grantor: You (or you and your spouse) are the grantor(s) of your trust. You are putting your assets into a virtual container. You may include some or all of your assets. You specify the terms by which income and assets are distributed during your lifetime and at your passing. You have control as long as you are alive and may change the terms as you deem appropriate.

Trustee: Any competent adult may be a trustee. In a revocable trust, you (or you and your spouse), are usually named as trustee (s) to maintain full control over the trust while you are living. You also may name a friend or relative as trustee. Be aware that this is an important responsibility. The trustee should have some experience or qualifications, as he/she will be managing the assets, paying income, preparing tax returns and distributing the trust contents at your death. In the event that a trustee dies or is unable or unwilling to act as a trustee, it is advisable to name a successor trustee.

Beneficiary: You and your spouse would be named as the first beneficiaries.

A beneficiary may be a person, multiple persons or an entity such as a charity. At your death the trustee will distribute the assets in the trust to those you have specifically named to receive them.

Funding your trust: You must transfer your assets, real estate, etc. to the trust by changing the title of your asset in order for it to be contained in the trust. If your house, cars, brokerage account, etc. are to be covered by the trust you must contact the proper authority and have a new title drawn up that would read "The Mary and John Smith Revocable Trust dated 1/10/09 for the benefit of Mary and John Smith" (or however your trust is titled).

Another note of caution: too often clients go through the time and expense of having a trust written and neglect to fund it making all that effort worthless.

Revocable Living Trust
(continued)

Benefits of a revocable living trust:

1. Avoids probate thus providing confidentiality by not having your assets as part of the public record.
2. Expedites the distribution of assets to your beneficiaries since the trust can operate without court supervision.
3. Permits financial management of your assets by your trustee in the event that you no longer wish to do so. or are incapacitated.
4. Provides for overall asset management in the event of incapacity without seeking guardianship or durable power of attorney.
5. Allows you to name guardians for minor children.

Drawbacks of a revocable living trust:

1. Does not eliminate the need for a will. A will supplements your trust in directing to whom and how other assets will be distributed.
2. Does not eliminate the costs associated with probate as documents, tax returns, etc. must be prepared by your trustee. He/she must receive compensation.
3. Reduces protection from creditors' claims after death.
4. Provides no reduction of estate taxes. All assets held in your trust will be included in your taxable estate.
5. Allows for no escape from income tax since all income earned by the assets in the trust is fully taxable because you can end a revocable living trust at any time.
6. Still requires a durable power of attorney if you hold assets outside of the trust.
7. Continues your exposure to Medicaid calculations for nursing home eligibility because you can revoke the trust (and take back the assets).

Will – Revocable (Living) Trust – Living Will

A **Will** is a legal document whereby you provide for your heirs and direct how your property will be distributed at your death. During your lifetime, you keep your assets and manage them yourself.

A **Revocable Trust** is a legal document whereby you turn over some or all of your assets to your trustee to manage while you are alive. It also allows you to direct how your assets will be managed in the event that you become incapacitated and, finally, how your assets will be distributed at your passing.

A **Living Will** is a document in which you state your preferences for life-prolonging medical procedures.

Market Activity

	Prices			Percent Changes	
Market Indicator	**12/31/2008**	**9/30/2009**	**12/31/2009**	**Last Year**	**Last Qtr**
1 Ounce of Gold *(London PM Fixing)*	843.50	991.50	1100.50	17.5%	11.0%
Technology Oriented Stocks *(NASDAQ Index)*	1530.24	2090.92	2269.15	36.6%	8.5%
Small Company Stocks *(Russell 2000 Index)*	476.77	598.94	625.39	25.6%	4.4%
International, Global Stocks *(EAFE Index)*	1210.76	1542.95	1580.77	27.4%	2.5%
Large Company Stocks *(S&P 500 Index)*	872.80	1044.38	1115.10	19.7%	6.8%
Higher Yielding Stocks *(DJ Utilities Index)*	359.43	377.00	398.01	4.9%	5.6%
High Yield Bonds *(M.L. High Yield Index)*	606.76	923.73	978.23	52.2%	5.9%
Tax Free Municipal Bonds *(Bond Buyer Index)*	97 8/32	114 10/32	112 5/32	17.5%	-1.9%
Long Term US Gov't Bonds *(Lehman Index)*	2109.97	1861.99	1751.94	-11.8%	-5.9%
Inflation *(Consumer Price Index)*	210.20	216.00	216.00	2.8%	0.0%

Source: Wall Street Journal, Barron's, and Yahoo Finance. An index is an unmanaged group of securities considered to be representative of the stock and bond markets in general. An index cannot be invested into directly and assumes dividends are not reinvested. In addition, past performance is not indicative of future results.

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