

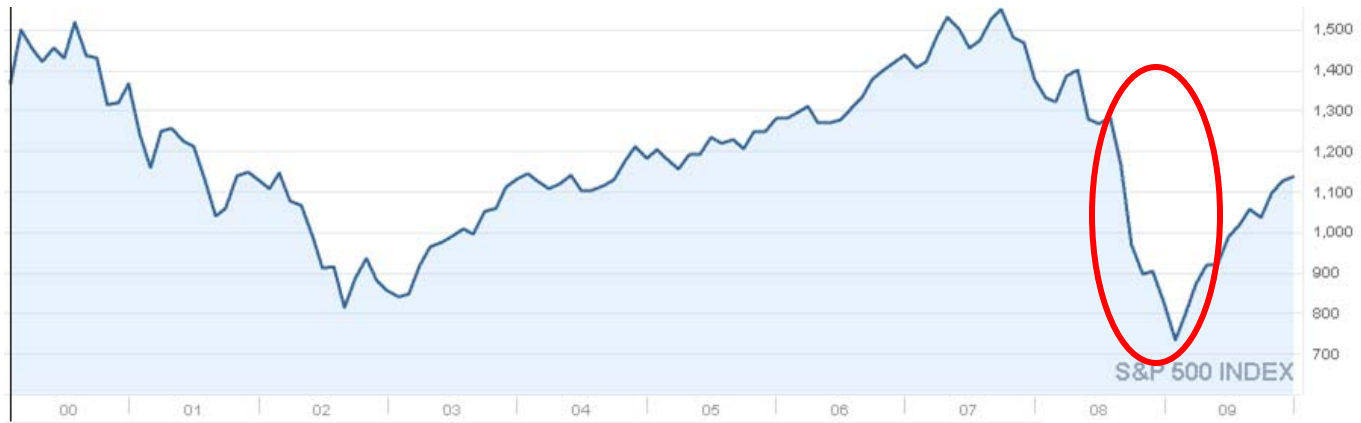
# PRAETORIAN<sup>SM</sup> GUARD



**CLIENT NEWSLETTER  
JANUARY 2010**

## 2009 YEAR IN REVIEW COMMENTARY

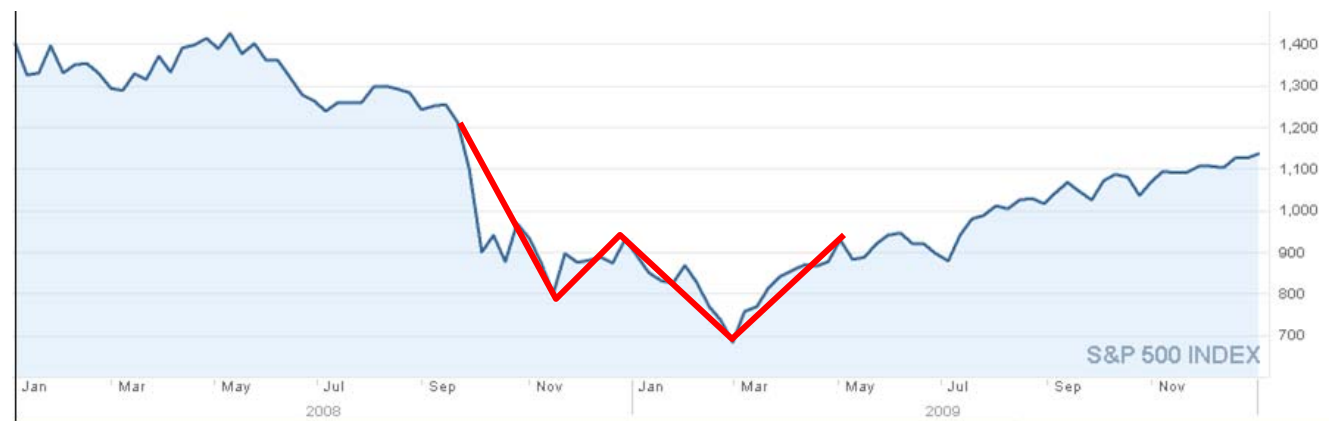
2009 was a year which ultimately will demonstrate the resilience of the world economy. Despite the headlines, economists and selected leaders have learned some lessons since the 1930s. The first two months were unquestionably “trying” times for everyone. The chart below of the S&P 500 shows the decline in January and February to be steeper and sharper than any other time during the tumultuous last ten years.



We believe the market was oversold at S&P 500 value of 647 in March 2009 and that the initial strong recovery is best considered a correction to the upside towards fair value. Looking at the last 9 months in greater detail, we detect steadily improving markets with repeated entrance points (red arrows) for very short term corrections. We feel that this will continue for the first six months of 2010.



After the March low, it is important to identify that each new low point is slightly higher beginning in July. We are confident that there will be additional entrance points while the markets continue to move higher in the first six months of ‘10. Finally, we believe we have already had the “double dip” as shown below on the graph with the red “W”.



## PRESIDENT'S COMMENTARY



Dick Hewitt

A return to a more rational, fundamental (rather than fear-driven) economy and market are perhaps one of the greatest blessings of the second half of 2009. Investors and markets are once again evaluating companies on their earnings, future forecasts for growth and competitive positions. This is a very good sign.

The state of the economy is getting better. There are still areas of concern, but most if not all will be self-correcting with time and economic growth (ie, unemployment rate).

This is an election year with several pivotal battles still being fought and a few still to begin in Washington. We will be following these three issues very closely: health care, energy policy writ large (include environmental policy) and tax policy.

Lastly, congratulations to Ed Leszynski who earned his Personal Financial Specialist designation this past fall.

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## TAX AND LEGISLATIVE UPDATE

As of this writing, the estate tax is repealed, but it will soon come back and most likely be retroactive to January 1st. We are finally approaching a final deal on this item and expect that we will see a \$3.5 million individual exemption and a tax rate of 45% when the legislation is finally passed.

Higher marginal tax rates are now less than one year away. The 2001 tax cuts sunset on December 31, 2010 and that means a return to the tax brackets of the 1990s, whereby the upper bracket is 39.6%, capital gains return to 20% and other related items increase. We believe that the increases will be more than just a return to 2001 levels, so for planning purposes we expect an upper bracket of 42-44%.

Finally, the income restriction on Roth IRA conversions has been lifted (effective January 1st). The impact is that anyone can convert a Traditional IRA to a Roth IRA, choose to pay the taxes in 2010 or spread them over 2011-2012 (albeit most likely at higher rates - see above). This affords high wage earners the opportunity to contribute to a Traditional IRA and immediately convert to a Roth IRA.

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## CLIENT SUPPORT AND TECHNOLOGY

We are delighted to announce that we have been selected by Charles Schwab as the pilot firm for its test of electronic signature technology. We will be partnering with DocuSign, a Seattle-based firm for this effort, which will run for most of 2010.

The technology will allow our clients to create a secure, encrypted electronic signature and handle the majority of Schwab's paperwork directly through e-mail and the web. The security enhancements are significant and it streamlines/speeds routine processes, allowing us to serve you better and faster.



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## GEO-POLITICAL WILD CARDS

The old adage “may you live in interesting times” definitely applies to the upcoming year. We believe there are at least three events that could quickly and radically change the economic and financial landscape:

**A. Collapse of the Government of Iran.** We rate this as having a 25% probability in 2010. The anti-government demonstrations are not only continuing, but are gaining sophistication and are technologically able to get their message out to the broader world despite government attempts to restrict communications. The impact would be a reduction in terrorist funding and a likely long-term increase in the supply of oil to the world market.

**B. Israeli Attack on Iran’s Nuclear Facilities.** This goes hand-in-hand with the above event, but the pressure on Israel to act will increase significantly over the course of the year. The economic impact of this would be a huge spike in the price of oil (\$150-225/barrel), closure of the Straits of Hormuz and increased terrorist activity worldwide. We rate this as having a 15% likelihood.

**C. Significant change in the composition of Congress following the 2010 mid term elections.** Ten months is a lifetime in politics, but we believe it is all but certain the Democrats will lose their filibuster-proof majority in the Senate and there is a 20% chance of the House of Representatives flipping control.

## THREE DATA POINTS TO WATCH FOR THE FIRST HALF OF 2010

The following statistics are the most important to watch in the first few months of 2010:

a. **Average Hourly Wage Rate.** In order for inflationary pressure to get a good foothold, wages have to rise faster than prices in the short-term. Absent this, the Fed can keep interest rates below historically accommodative levels through most of 2010.

b. **Productivity.** This is another brake on inflation and as long as productivity remains higher than the average hourly wage increase, per unit costs of production will decline. Look for this value to exceed 4% for the first two quarters of the year.

c. **Fed Funds Target Rate.** While there is a lot of hand-wringing attempting to determine when the Fed will raise this key rate, we think this is the wrong question. In fact, the most important questions are how quickly do they raise rates (we expect .25% increments beginning in May) and where and when do they stop raising rates (we think 3% by mid 2011)?

## CLOSING THOUGHT

“The hardest thing in the world to understand is the income tax.”

Albert Einstein