

PRESTIGE WEALTH MANAGEMENT GROUP

Retirement Planning & Distribution Specialists

3rd Quarter 2010 Newsletter

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Bonnie Brae CEO William Powers, center, and Director of Development Nancy Hoffman, 4th from left in orange, pose with Roy Williams, Steve Linden, Tom McCabe and the rest of the Prestige Wealth Management Group family at our 4th Annual Charity Golf Outing, at which we raised over \$12,000 for Bonnie Brae.

For more information about Bonnie Brae, please visit their website:
www.bonnie-brae.org

Prestige Wealth Management Group



NOVEMBER 2010

Wow— it's already fall and 2010 has proven to be a very wild ride for the stock market!

September was the strongest September on a percentage basis for the Dow Jones Industrial Average in 71 years. (Source: WSJ, October 4th, "Trading Volumes Sink..." C2) The Dow increased 7.7% in a fairly steady climb throughout September, rather than the volatile swings seen earlier in the year. It also increased 10.4% for the quarter and year-to-date was 3.5%. The S&P 500 gained 8.5% total return in September, its best September results since 1939 and its fourth best performance for any month in the last twenty years.

(Source: BTN Research) The S&P 500 is up 3.9% year-to-date through September 30th and ended the quarter at 11.3%. The NASDAQ also is up 4.4% for the year through September 30th. It also increased 12.3% for the quarter.

The stock market has just posted its best September in decades, but the third quarter volume in stock trading was about 25% below the second quarter level. Does September's rally signal a broad return of investor confidence? It appears that some market participants felt less of a need for hedging strategies amid lower volatility.

In this issue, we take a look at the US and global economies, unemployment, inflation vs. deflation, interest rates and the tax law changes.

On another note, we are pleased to announce that our 4th Annual Charity Golf Outing was a huge success. Thanks to the generosity of our clients and partners we were able to donate over \$12,000 to the Bonnie Brae School and Residential Treatment Center for Adolescent Boys.

We continue to strive to keep you informed of the markets and tax laws. We hope that you enjoy this quarter's newsletter.

Sincerely,

Roy Williams, ChFC
Chief Executive Officer

Steven Linden, CPA
Chief Financial Officer

Thomas McCabe, CPA
Chief Operating Officer



Third Quarter Highlights

There were a number of reasons the third quarter ended up on such a high note – there was a lot of good news:

Fears about a worst-case, European-led global meltdown have eased. Though risks still remain, actions to rein in deficits, combined with stiff financial backing from the European Union and the IMF, have investors less worried about the scenario today than they have been in the recent past. (Source: Kiplinger Letter, August 2010)

August of 2010 was the busiest on record for mergers and acquisitions volume worldwide. The \$286 billion worth of deals announced marked the highest monthly level since July of 2008, according to Dealogic. (Source: CNNmoney.com, September 7, 2010) Global volume of mergers and acquisitions was at \$1.8 trillion as of August 31, 2010, up 24% from the previous year.

And yet more good news this past quarter—BP declared its Gulf of Mexico well permanently sealed on Sunday, September 26. There is much cleanup work to be done, but at least there's no more oil leaking into the ocean.

Despite all this good news, the question remains—what awaits right around the corner? Recovery or double-dip recession? The U.S. economy and stock market are still sending mixed and confusing signals. And while many investors are making the “glass is half full” argument, thanks in large part to the dismal economy we still have discontent with government.

- Most Americans are more critical of their government these days, with one report putting trust in government at a historic low of 22%.
- Only 25% have a favorable view of Congress—the lowest favorable ratings in more than two decades.

- Americans don't have much faith in Wall Street either. 71% say they believe the financial industry played a major role in causing the current recession. (Source: Zogby International, August 9, 2010)

Confidence is an important but fragile commodity. Lack of confidence in the course of the recovery has caused great concern for the various stock markets for much of this year. Only in September did many investors finally see enough positive economic data and corporate earnings growth to budge stocks upward again.

U.S. Economy

The recession is over! (In September, the National Bureau of Economic Research announced that the recession officially ended in June 2009.) But is the economy really growing? Yes, although so slowly that most Americans probably can't feel it yet. With millions of would-be workers jobless, foreclosures rising and home prices still as low as they are, to many folks, it may feel as if the economy is still shrinking. The problem is that it is such a long climb back up from the trough that the economy fell into. The trend is in the right direction, but unemployment, output, real estate, housing construction and sales fell so sharply that it could be months or even longer before we can see much daylight. (Source: Kiplinger Letter, August 2010)

That is assuming the recent growth rate continues. Unfortunately, when growth is weak, unemployment is likely to remain high, and wage growth will be low or non-existent. That makes it difficult for consumers to increase spending or businesses to either raise prices or justify investing in expansions.

Even as job creation remains weak, U.S. companies are rebounding and corporate profits are at record levels. This is the result of companies' efforts to aggressively retool their operations to cope with lower revenue and an uncertain economic outlook.

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An analysis by the Wall Street Journal found that the companies in the Standard and Poor's 500 Stock Index posted second quarter profits of \$189 billion, up 38% from a year earlier in their sixth-highest quarterly total ever, without adjustment for inflation. The strong growth is expected to continue for the fourth quarter as companies begin reporting their results.

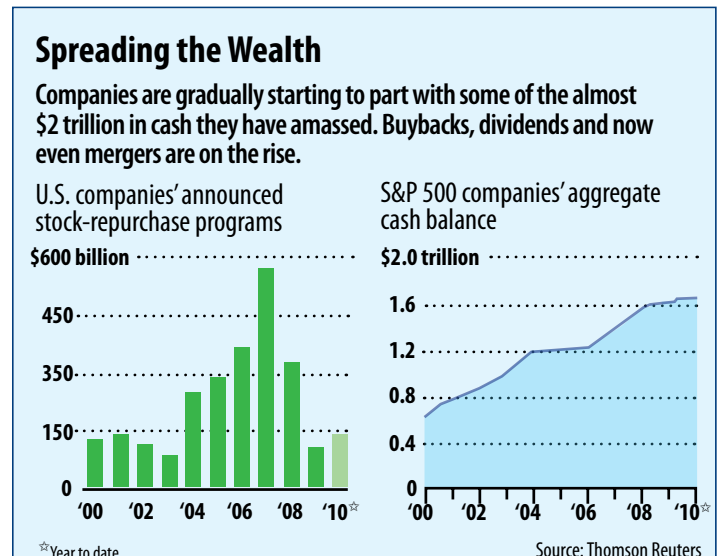
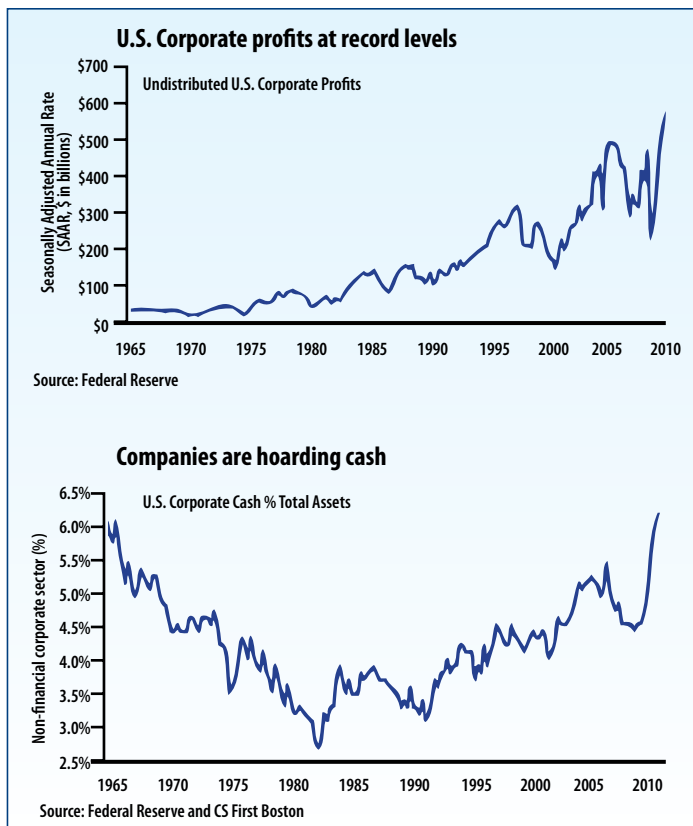
Despite profit levels, many business executives find the increasing government regulation of the U.S. corporate tax regime discouraging for new business, job creation and capital investment. The combined federal and state corporate tax rate is 39.1%, the second highest overall corporate tax among industrialized countries, according to the 2009 paper from the Tax Foundation. (Source: PIMCO U.S. Credit Perspectives, July 2010)

Many investors believe that corporate investment will be an important aspect of economic growth. Despite the hefty profits, most companies are not

expected to boost spending on new employees, products or equipment any time soon. Employers usually keep a lid on spending for as long as two years after the bottom of the recession, then invest as demand stabilizes, according to Ed Yardeni, President of Yardeni Research, an economic consulting firm. (Source: WSJ, October 4th, "Propelling the Profit Comeback" B1)

Many corporations are holding record amounts of cash in low yielding fixed-income instruments—nearly \$1.8 trillion, which is \$600 billion more than normal—as they wait to see the outcome of policy and regulatory decisions, according to Martin Regalia, chief economist at the U.S. Chamber of Commerce. "As a rule, businesses don't hold that kind of cash, because it doesn't earn anything," said Mr. Regalia. "It is an indication that uncertainty is palpable and it is affecting economic growth." (Source: Investment News, "Retroactive estate tax for 2010..." August 22, 2010)

To many shareholders looking for a fair return on their investment, this appears to be an unsatisfactory use of resources. Dividend increases, stock buybacks, acquisitions and higher capital spending would seem to be more appropriate uses of corporate cash than leaving it in these low yielding instruments. It's possible that there could be a surge in





special dividends during the last quarter of 2010. These are often one-time payouts and sometimes companies pay them even if they don't make regular distributions.

Corporations have good reason to share some of their profits sooner rather than later: unless Congress acts before the end of the year, the top federal income-tax rate on corporate dividends will rise from 15% in 2010 to nearly 40% in 2011! Any corporate dividend paid by the end of December, special or regular, will qualify for the lower 15% tax rate. Please remember that the prospect of the special dividend should not by itself be the reason to buy a stock. Don't let the tax tail wag the dog!

Global Economy

World trade has come roaring back to within 2% of its old peak (see chart). The collapse and rebound in trade played an important role in the global recession and recovery; now it may be the key to how strongly the global economy can grow.



The International Monetary Fund predicts that the global economy will grow by 4.2% over 2011 (although America and other developed countries are expected to experience continued sluggish growth because of budget cuts). (Source: The Economist, October 9th, pg16) The 2010 4.8% growth is well above the recent growth rate of 4%. Yet there is a gap between the vitality of the big emerging economies (some of which are close to 10%) and the sluggish growth of many developed countries.

Unemployment

The U.S. economy lost 95,000 jobs in September—more than expected, thanks to a smaller-than-forecast rise in private-sector employment to offset cuts by state and local governments. The jobs report increased expectations that the Fed would take more steps to stimulate the economy at its next meeting. (Source: Barron's, October 11th, "Punk Payroll..." pg 8)

Quantitative Easing

Many investors believe that the Federal Reserve will have to launch another big bond-buying program by the end of the year to help keep interest rates low and prevent the economy from tumbling into another recession. This is referred to as "quantitative easing" (QE). QE creates more money to purchase assets and is often used as a way to stimulate the domestic economy by lowering the costs to finance and putting more money into the banking system. Unfortunately, the dollar has fallen 7% in the six weeks since the Federal Reserve began discussing it. (Wall Street Journal, "Dollars Fall Rocks World" A1)

The prospect of further QE by the Federal Reserve helps to explain why gold, equities and bonds are all performing well at the same time—an unusual circumstance. Investors are buying gold in case QE leads to inflation, and stocks in hopes that QE will revive the economy and head off a double-dip recession. In addition, the yields on many bonds have fallen because the Federal Reserve often spends most of the QE money buying our own country's debt. With inflation and deflation both possible consequences of a debt crisis, some investors are buying gold as a hedge against inflation and bonds as a hedge against deflation.

Inflation or Deflation

Will it be deflation, inflation or both?

Either inflation or deflation could be damaging to businesses. During high inflation, rising costs eat into the bottom line, and companies may not be able to boost profits to fully compensate. The deflation worry is that consumers, expecting prices to fall, will cut back on purchases. Why buy something today that is expected to cost less next week? That in turn can lead to more layoffs, and therefore less demand, and trigger a spiral of sliding prices.

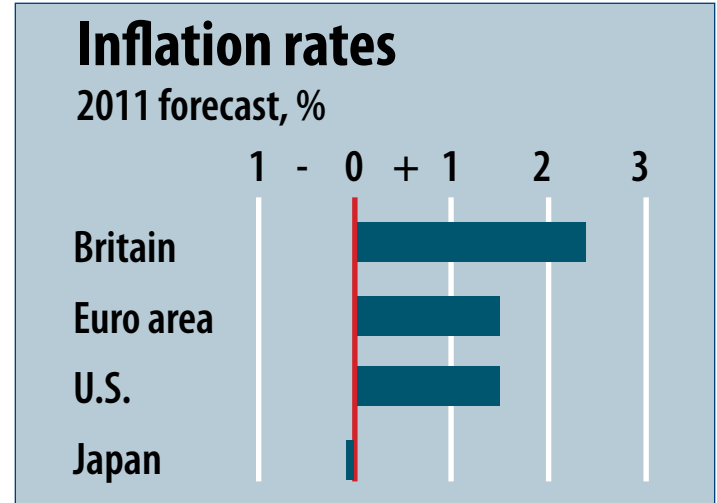
So, what can investors do to guard their portfolios in the event of deflation or inflation? There is no absolute answer and individual situations will vary, but many investors believe that blue-chip stocks that pay dividends and technology shares often do well in either scenario. However, there is no guarantee of this, so diversification among different asset classes appears to be prudent. (Source: WSJ, October 4th, "Inflation or Deflation")

Many investors believe that emerging markets with strong fiscal and trade surpluses and strong economic growth should also hold up well, along with bonds, during a deflationary period. Cash is king in a deflationary environment. While investors may not earn much interest, cash gains in value while prices fall.

Inflation has dropped considerably over the last ten years (see chart), and compared to a year ago, overall prices are up just 1.3% and "core" CPI – excluding food and energy – is up only 1%. Inflation is expected to vary in different countries, with about 1.5% forecast for the U.S.

One of the reasons for such a low inflation is that many consumers are afraid to spend and instead are saving. The nation's savings rate was 5.8% as of August 31, 2010. Just three years ago it was 1.7%. (Source: BTN, October 11, 2010, Commerce Department) Although this usually would be good

news, the U.S. economy is dependent on consumer spending. Figures released by the Commerce Department in July showed that 70% of the nation's Gross Domestic Product (GDP) is made up of consumption. When we spend less, we grow more slowly and we create fewer jobs.



So, how do we get people to spend now rather than wait? That is not so easy to do. For many, there is a psychological block that is hard to overcome. For reference, see the economy of Japan, which has been stuck with this type of problem for most of the past 25 years. For that period of time, Japan (and more recently the U.S.) chose to substitute government spending for private consumption. It hasn't worked for the Japanese and it may not work for us either. Until consumers have more confidence and a feeling of greater security, they are not likely to increase their spending and we are not likely to see much of a recovery. (Source: Bob LeClair's Finance & Markets Newsletter) So remember—it's not just shopping, it's retail therapy!

Interest Rate Risk

If inflation starts to increase, the Fed may start to raise interest rates to keep inflation in check. If interest rates go up, bonds usually go down in value.



Interest rates don't have to rise much for bond investors to realize substantial losses—in fact, even the fear of interest rates going up is often enough for the value of bonds to go down.

While bonds are less volatile than stocks and have guarantees that stocks don't, bonds are far riskier than some investors appreciate. Interest rates are at their lowest levels since the 1950s. Investors who grasp for that last percentage point of yield and buy long-term bonds are making a gigantic bet that rates will fall even further or at least hold even. However, with rates this low, the question really isn't if they will rise, but when. If inflation rears its ugly head and interest rates rise, investors would still receive their investment back if they hold their bonds until maturity—but not in real terms of course. If they sold after rates rose but before bond maturity they'd suffer a loss.

New Tax Law Changes

At the time of this writing, consumers and businesses lack certainty about the future impact of income taxes. President Obama wants to keep current tax breaks for lower and middle income taxpayers, but favors higher rates for the wealthiest 3% of Americans—singles whose taxable income exceeds \$200,000 and married couples with taxable income above \$250,000. Congressional Republicans argue that current tax rates should be extended for everyone, noting that many of the taxpayers targeted for tax hikes are small business owners and that higher taxes on them could derail the economic recovery.

Normally, when performing year-end tax planning, it makes sense to reduce your income and increase tax deductions as a way to reduce your tax bill. If Congress extends the current tax rates for your income level, that's probably what you should do. However, if your tax rates will increase in 2011, it may make more sense to reverse that strategy—accelerate discretionary income (such as a year-end

bonus) into the current year, when your income tax rates are lower, and push donations into January when they will deliver a bigger tax-saving bang for each buck you deduct.

We will keep you updated as the government finalizes what they are going to do with the tax laws.

Conclusion

Today's investment climate appears to be a paradox—a desire for safety and a craving for yield. In fixed-income markets, the flight to safety has driven bond yields to all-time lows. At the same time, investors are pouring money into emerging markets and junk bond debt at a record pace. In the stock markets, many investors are torn between their frustration at the lousy returns of blue-chip stocks over the past ten years and their expectation that stocks should outperform other investments. As a result, many of the least-risky blue-chip stocks are still extremely cheap, while the shares of some firms with less-predictable or speculative prospects are expensive. (Source: Kiplinger's Personal Finance, November 2010, #33)

For example, the average growth stock in the Standard and Poor's 500 Stock Index is currently trading at 16.2 times the past twelve month's earnings. That compares to an average price-to-earnings ratio of 20.6 since 1995, according to Birinyi Associates, which illustrates that the values are a much better bargain today than they have been in the past. (Source: WSJ, October 4th, "Growth & Income")

As this report has shown, there are obviously many factors to take into consideration before investing into anything! However, you should still consider keeping an adequate liquidity, and diversifying properly. If you have any questions on any of the material presented in this newsletter, please do not hesitate to contact us at 908.782.0001.

If you'd like a copy of this article sent to someone else who would benefit from this information, please contact Prestige Wealth Management Group at 908.782.0001.



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Due to volatility within the markets mentioned, opinions are subject to change without notice. Information is based on sources believed to be reliable; however, their accuracy or completeness cannot be guaranteed.

Indexes cannot be invested in directly, are unmanaged and do not incur management fees, costs or expenses. No investment strategy, such as asset allocation, can guarantee a profit or protect against loss in periods of declining values. International investing involves special risks not present with U.S. investments due to factors such as increased volatility, currency fluctuation and differences in auditing and other financial standards. These risks can be accentuated in emerging markets.

There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment. Rebalancing investments may cause investors to incur transaction costs and, when rebalancing a non-retirement account, taxable events will be created that may increase your tax liability.

This optimism about the future does not minimize the fact that we have gone through one of the worst economic periods in market history. Remember that equity markets are volatile and an investor may lose

money and there is no guarantee that securities will appreciate. This material contains forward looking statements and projections. There are no guarantees that these results will be achieved.

The price of commodities is subject to substantial price fluctuations of short periods of time and may be affected by unpredictable international monetary and political policies. The market for commodities is widely unregulated and concentrated investing may lead to higher price volatility.

In general, the bond market is volatile, bond prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss. The investor should note that investments in lower-rated debt securities (commonly referred to as junk bonds) involve additional risks because of the lower credit quality of the securities in the portfolio. The investor should be aware of the possible higher level of volatility, and increased risk of default.

Investments in real estate have various risks including possible lack of liquidity and devaluation based on adverse economic and regulatory changes.

Sources: Wall Street Journal (6/8/10, 6/10/10, 6/11/10), By The Numbers (3/15/10, 5/24/10, 6/14/10), Barron's (6/14/10), Times Magazine (5/3/10), Kiplinger's Personal Finance (6/9/10, 8/2010), The Economist (6/5/10, 6/19/10), Bob LeClair's Finance Newsletter (6/26/10), Forbes (7/19/10), Nick Murray Interactive (September 2009), Fortune Magazine (5/24/10, 7/5/10), Market Watch (7/8/10), Dow Theory Forecasts (6/14/10), Investment News (7/6/10), AARP Magazine (June 2010), Monday Morning Outlook Newsletter (6/7/10), MDP, Inc.

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