THE NEW ENGLAND GUILD, INC.

WEALTH MANAGEMENT COMMENTARY

PROTECTING AND BUILDING YOUR FINANCIAL FUTURE

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Market Spotlight

Index	Returns			
	Qtly	Annual		
	1st Qtr	1 Yr	3 Yrs	10 Yrs
Equities				
S&P 500	5.4%	49.8%	-4.2%	-0.7%
Russell 2000	8.9%	62.8%	-4.0%	3.7%
MSCI EAFE (Int'l)	0.9%	54.4%	-7.0%	1.3%
FTSE NAREIT	10.0%	106.7%	-10.6%	11.4%
Bonds & Cash				
Barcap Agg. Bond	1.8%	7.7%	6.1%	6.3%
90 Day T-Bills	0.0%	0.1%	1.8%	2.7%

Global equity markets now have rallied 76.8% from March 2009 lows, leaving investors 20.9% below the October 2007 market high. During the first quarter, just about every aspect of the market posted positive returns: domestic stocks large and small; foreign stocks; gold; the dollar; high yield and muni bonds; even most treasuries. REITs registered double digit returns; while large, mid, small cap value outperformed their growth counterparts. As Jason Zweig pointed out in a recent WSJ article, if you were alive this quarter, you made money!

It would appear that the deep recession that began two years ago ended in mid-2009. Economic activity began to pick up during the second half of the year with inflation-adjusted GDP showing two quarters of positive gains. Exports and imports have risen; fourth quarter earnings brought positive surprises; industrial production has shown signs of improving; and, better than expected retail sales were reported during the quarter.

Although the financial and economic storms are clearing and the economic expansion appears to be on firmer footing, it's a long way back to either an old or new "normal". As importantly, the sustainability of the recovery is far from a foregone conclusion. Consumer and bank balance sheets have improved but remain damaged. Government intervention in the form of accommodative policies and global stimulus brought about positive GDP in the third and fourth quarters - but at a massive cost. And what will happen once that support wanes remains largely an unknown.

We believe that economic growth in the next few years will be muted in the aftermath of this global downdraft. Unemployment hovers at 10%. Spending by households is likely to be constrained by slow growth of income, lost wealth, and continued limits on their ability to borrow. Housing starts and car sales remain extremely low. Inventories are no longer in free fall but neither are they rebuilding. Although corporate balance sheets look financially healthier, capital spending remains subdued. At the same time, smaller companies continue to face difficulties borrowing.

While excess capacity and reduced demand in the economy are keeping prices low and point to deflationary pressure in the near term, inflationary fears loom longer term as a result of stimulus spending and the amount of liquidity that has been pumped into the system to halt the global financial free-fall. Recently, the Federal Open Market Committee signaled their intention to keep interest rates low for an extended period of time. However, with the debt to GDP ratio growing in the US and overseas, it is unclear as to how long it will be before interest rates start to rise again. All of this points to considerable uncertainty for the markets.

In a 1963 speech, the great value investor Benjamin Graham warned that "a large advance in the stock market is basically a sign for caution and not a reason for confidence". So although it feels good to have regained some of what the market took away these past few years, it should not be a time for complacency.

Investment Commentary

THE GAME OF INVESTING

Clients have expectations of us as investment professionals. They expect us to provide sound, objective investment advice that fulfills their particular needs and produces satisfactory investment results over time. For some clients these expectations are simple and straight forward: they want high returns and low risk! Or, said another way, beat the market on the upside and avoid loss on the downside. Anything short of this is a disappointment. Unfortunately, the markets of the past few years have not been conducive to delivering on these expectations.

What many lay investors do not appreciate is that markets are simply a measuring rod of future expectations. Current prices reflect the present values of expected future cash flows. To outperform markets is not about understanding the fundamentals of economies and businesses but rather about understanding the future fundamentals of economies and businesses *better than* the consensus of investors, who as a group are setting prices.

Two recent events provide helpful analogies. 'March Madness' is a favorite time of year. Everyone enjoys entering a pool in which selections reflect informed judgment, intuition and guesswork. Consider this: there are 63 games (actually 64 with the play-in game) played in the NCAA tournament. One would think the NCAA Tournament Selection Committee that ranks the 64 teams would have a high rate of success in predicting winners. They do: they were right in 42 of 63 games for a 67% success rate. Now introduce the betting line which sets an expected scoring spread on each game – a handicap system introducing expectations of interested parties (does this sound like a market?). If one had picked the higher ranked teams to win by more than the point spread, one would have correctly picked 33/65 winners for a 51% success rate. Kind of like flipping a coin!

The ranking of teams considers each team's relative fundamentals much as we think about a company's earnings growth, market share, or superior management. A price-earnings (PE) ratio is like a point spread, typically higher for companies with faster growth prospects. Future investment returns (game outcomes) are therefore handicapped by expectations of earnings growth as reflected in the PE. As with the NCAA tournament, it is much more difficult to pick winners when the fundamentals are handicapped. The same applies for markets.

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INVESTMENT COMMENTARY

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A second analogy that adds perspective is the recent earthquake in Haiti (but hurricanes, floods and tsunamis could be used as well). This is a 'Black Swan' event, highly improbable but with potentially catastrophic consequences. One cannot rely on forecasting as to when such an event will occur. So - how should one deal with this type of risk? Choices are to eliminate risk exposure completely by moving away (therefore taking on other kinds of risks); to purchase flood or earthquake insurance (at very high premium cost); to stay and take reasonable precautions (stronger foundation for the house, store valuables elsewhere); or to do nothing, hoping for the best. There is no right or wrong answer (except in retrospect); it is a case of individual choice based on circumstance, values and priorities.

All of which is to say that investing is a difficult endeavor. Acknowledging this, we try to simplify the process by doing three things (at least) to achieve client satisfaction. First, we try to understand a client's individual risk profile in order to construct a portfolio that has a high probability of success over time but, like the NCAA Selection Committee, may not be right 100% of the time. Second, we do extensive due diligence on the investment managers we use to implement a client's plan; that is, we try to rely more heavily on informed judgment than on intuition or guesstimates. While the record is not perfect, we think the evidence of our own experience is favorable and not random. And thirdly, we pay close attention to the other factors that impact realized return, such as costs, taxes and estate planning issues. In other words, we respect uncertainty, expect surprise, and do our best to understand our clients' interests.

QUOTE

"Hindsight is an exact science."

- Guy Bellamy

Greater Security

It's generally true that what goes up must come down. One exception is Social Security income, which increases from age 62 to 70 if you either delay taking it or return what you have already collected. Let's examine each approach, while keeping in mind the benefit can be maximized by waiting until age 70 to start collecting the income.

Put It Off

Most people are eager to receive lifetime income that rises with the cost of living. In fact, roughly two-thirds of Americans begin collecting Social Security income at the earliest possible age of 62. But, claiming it early reduces your benefit by as much as 30% from what you would receive by waiting until your Full Retirement Age (65 to 67 years depending on your age). Better still if you wait until after Full Retirement Age, when your benefit increases by up to 8% per year to age 70. For married couples, the advantage of waiting is even more pronounced. An individual at Full Retirement can collect 50% of the Social Security benefit of the retired spouse, while living, and ultimately 100% of that benefit as the surviving spouse. Thus, waiting can increase lifetime income for both you and your surviving spouse.

Return to Sender

Even if you have already applied for or begun taking Social Security benefits, you can reverse your decision if you are below age 70. If you have applied, you can suspend the claim and restart the benefits at a later age. If you have begun collecting the benefit, you must repay in lump sum the accumulated income you (and your spouse) have received. But, there are at least a couple of caveats. First, if death occurs prior to returning the collected benefits, your spouse would continue to receive the lower benefit amount. Second, the process can become complicated when attempting to recoup taxes paid on collected benefits.

It is best to discuss these decisions with your financial advisor in the context of your specific situation, with attention paid to income needs and tax consequences.

Health Care Impacts

Like it or not, national health care is around the corner and there are important implications:

Income Taxes: In 2013, Medicare tax increases to 2.35% for families making in excess of $250,000 and individuals making over $200,000. For the same group, investment income (i.e., dividends, capital gains, rental income and royalties) will be subject to a 3.8% tax.

Itemized Deduction: Starting in 2013, taxpayers can deduct medical expenses that exceed 10% (up from 7.5%) of their income. Those 65 and older are exempt from this change through 2016.

Excise Tax: 2018 will bring a 40% excise tax on that portion of premium that exceeds $10,200 and $27,500 for individual and family plans, respectively.

Individual Mandate: An individual must buy health insurance by 2014 or pay an annual tax on income of 1%, rising to 2.5% by 2016.

Medical Expense Accounts: In 2011, non-qualified withdrawals will have a 20% penalty, and over-the-counter drug purchases will be disallowed in medical expense accounts. In 2013, the annual contribution limit for flexible savings accounts will be $2,500.

EXCURSION

For authentic Mexican dining, head north of the border? That's right – to West Hartford's Blue Back Square. *Besito Mexican Restaurant* has migrated north from its well-established Long Island, NY location, hailed by the New York Times as "leaving the competition in the dust." From months of research in Mexico, owner John Tunney has created not only a realistic ambiance, but also an authentic menu, stocked with familiar fare and then some. From table-side made guacamole to the churros dessert, you are in for a treat with these standouts and everything in between. Before heading there for lunch, dinner or even Sunday brunch, check them out at www.besitomex.com.

Our firm continues to grow by referrals from our clients. Thank you for recommending us.

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