NEW ENGLAND GUILD
Wealth Management & Investment Advisors

WEALTH MANAGEMENT COMMENTARY

PROTECTING AND BUILDING YOUR FINANCIAL FUTURE

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Market Spotlight

Index	Returns Qtr	Annual		
	2 Qtr	1 YR	3 YR	10YR
Equities				
S&P 500	0.1%	30.7%	3.3%	2.7%
Russell 2000	-1.6%	37.4%	7.8%	6.3%
MSCI AC World exUS	0.4%	29.7%	-0.4%	7.5%
DJ US REIT	4.0%	35.0%	4.7%	10.5%
Bonds & Cash				
Barcap Agg. Bond	2.3%	3.9%	6.5%	5.7%
90 Day T-Bills	0.0%	0.1%	0.3%	2.0%

After posting the best opening 3 months of the year in more than a decade, the S&P 500 Index continued its upward trend through April amid news of natural disaster, political unrest, and rising oil prices. However, the uncertainty that defined the economy in 2010 returned to the markets in May as concerns deepened over a global slowdown, the sovereign debt crisis in Europe, and an impending end to the Federal Reserve's quantitative easing program (QE2). Although moves to avert a European debt crisis boosted US markets late in June, a number of asset classes ended the quarter in negative territory erasing a good portion of the year's gains. The S&P 500 Index finished the quarter flat, outperforming US Small Cap and Emerging Markets but underperforming International Stocks. On the positive side, REITs advanced 4.0% while a renewed flight to safety resulted in solid gains for bonds.

Until recently, markets were remarkably resilient despite all the shocks in 2011. However, the "black swans" that are out there remain scary. Headlines remind people daily to *expect the unexpected* with troubles in the Middle East posing threats to oil supplies and disasters in Japan creating disruptions in technology and the auto industry. Although inflation remains far from double digit levels seen over three decades ago, higher energy and commodity costs are taking a toll on consumers and producers alike. At the same time, historically low interest rates are fueling investor fears that rates have nowhere to go but up. While profitable, and operating at a high level of productivity, corporations in the S&P 500 are sitting on more than $960 billion in cash, a record. The problem: they aren't hiring; nor are they eager to bring offshore cash back to the US for stock buy-backs, capital investments or acquisitions without a

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Investment Commentary

PERFORMANCE MEASUREMENT

Surprising as it may seem, many investors don't have a clue as to how their investments are doing. While some investors "don't know and don't care', most others do care, but don't have the information or know-how to calculate the performance of their whole portfolio. Instead they rely on 'selective recall', which typically means remembering the individual stocks or funds that have done well and, hopefully, forgetting about the ones that do poorly. Others measure success by whether the portfolio is rising or falling in value, as determined by comparing the account value of the most recent brokerage statement with either the prior statement, or with the highest value shown on any previous statement.

We think these approaches are too simplistic and prone to misinterpretation. Performance measurement is too important a part of the investment process to be treated casually because it provides critical feedback to the investor on two important matters: ***1) how well is the investor doing (financial well-being), and 2) how effective are the investment decisions that are being made (investment management).***

With respect to the first purpose of performance – how well is the investor doing – *the important measures of success are absolute returns and real, or inflation-adjusted, returns. The terminology for these calculations is the "internal rate of return" (IRR)* or *"dollar weighted return" (DWR)* since they take into account the timing and magnitude of cash flows into and out of the portfolio. They provide information as to whether or not the portfolio is growing at a rate sufficient to meet a future goal or need as might be consistent with an investment return assumption used in a financial planning model.

The second purpose of performance measurement evaluates investment decisions *relative to an appropriate benchmark. This calculation uses a 'time-weighted rate of return' (TWR)* which removes the impact of capital flows into or out of the portfolio since the manager typically has no control over deposits or withdrawals. Typically overall portfolio results are compared against the performance of a benchmark of market indices that replicate the client's investment objectives, but it should also compare the portfolio's returns by asset class against asset class benchmarks, and by individual holding against the appropriate index benchmark for that holding. The reason for benchmarking is that investors always have the option of investing in an index fund with very low expenses. (Elsewhere in this Commentary we discuss the historic performance of index funds.)

Benchmarking triggers the competitive juices of investment managers by providing ongoing measures of relative success. We are reminded of the story of two portfolio managers hiking in the woods. They spot a large black bear. Both turn and run. But then one stops, takes off his backpack to put on his running shoes. The other portfolio manager says, "What are you doing; you can't outrun that bear?" "I don't have to outrun the bear," says the first portfolio manager, "I just have to outrun you!"

We believe strongly in performance measurement and benchmarking. We think clients should know if their results are consistent with plan expectations or not, and whether some adjustments are in order. And we think clients are entitled to know if a manager is managing their assets well or not, as well as the reasons for success or failure. Feedback invites learning and learning improves the probabilities for success over time, both for the client and for the manager.

Diversification

For those in despair that the experience of 2007-2009 has discredited the concept of diversification, take heart. In a recent article in the Financial Analyst Journal, "International Diversification Works (Eventually)", Clifford Assness, Roni Israelov and John Liew present their study of global markets from 1950 to 2008. They acknowledge that international diversification does not protect investors against short term market crashes because markets become more correlated during downturns when global multiple contraction dominates market performance. Over the long-term, however, country-specific economic performance dominates stock market performance. Therefore, over longer horizons international diversification does an excellent job of protecting investors.

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repatriation holiday that would eliminate or reduce significant tax consequences. June 30th brings an end to the Government's efforts to infuse liquidity into the system yet lending remains tight for both businesses and individuals. And amidst a backdrop of stubborn unemployment hovering at 9% and a troubled housing market, visibility around future taxes remains unclear, and political dysfunction poses barriers to resolving unsustainable levels of debt.

So how do investors maintain a prudent long-term view, when short term concerns like those above become long term worries? Said another way – how do you manage risk with all this uncertainty? Playing it too safe by not "dressing for the game" can lead to not having enough money when you need it – a risk you don't want to take. So although market risk is inescapable, it can be dampened through diversification as this quarter has proven. Diversification is about minimizing risk; it's not about maximizing return. And diversifying can also mean owning unpopular asset classes because you could be wrong!

The late Peter Bernstein, financial markets historian and student of risk management once observed, "If you are comfortable with everything you own, you're not diversified". His advice; "You hate bonds: you ought to own bonds. You're scared to death of stocks – own stocks, because maybe things will have a happy ending"! In the meantime, how do you deal with the all-important "sleep at night factor"? Set aside the cash you need for the next 5 years so you don't risk selling assets when Mr. Market's wild ride is experiencing a downdraft!

CT Tax Changes

Several state tax law changes occurred with the May 4th enactment of CT's budget bill. While many of the changes don't directly (note, the term directly) affect most individuals, there are a number that affect all CT taxpayers and a few that significantly impact those in the higher income and wealth brackets.

Income Taxes: Effective 1/1/2011 (note the backdated application of income tax brackets), the old three-tiered CT income tax bracket structure was changed to a five-tiered system with a new higher rate of 6.7% that is applied to ***all*** income of joint filers with CT AGI of $700,000 or more, effectively increasing the tax bill on $700,000 by $12,300, or 35%. While this tax bracket will experience the most significant increase, most taxpayers will experience higher CT income taxes effective 1/1/2011. Therefore, individuals should consider their existing CT withholding and/or estimated payments to ensure that they don't run into an underpayment penalty when filing their 2011 CT returns.

Estate Taxes: CT residents dying after 1/1/2011 with an estate valued in excess of $2 million (after any marital exclusions, if applicable) will now be subject to estate taxes at the rate of 7.2% of the excess over $2 million but under $3.5 million. Estates above $3.5 million will be taxed at higher rates that progressively increase to as much as 12%. Prior to this change, only estates in excess of $3.5 million were subject to CT estate taxes. Taxable gifts made after 1/1/2005 will be taken into account in determining the taxable estate for CT purposes.

Conveyance Taxes: Conveyance taxes paid to the state on real estate transfers will increase by at least .25% on the sale price, effective 7/1/2011. Further increases will likely be enacted by several municipalities based on legislation passed in this budget bill.

Sales Tax: Lastly, the CT sales tax rate increases to 6.35% effective 7/1/2011.

EXCURSION

The Polytechnic ON20 – so named because it occupies the 20th floor of the Hartford Steam Boiler Building - combines delicious dining with dramatic views of Hartford and the CT River! Formerly a private club, the sky high restaurant features Irish chef Noel Jones and offers both a la carte ordering as well as prix-fixe meals. It is open for lunch weekdays with CocktailsON20 and an a la carte dinner on Fridays. Be sure to save room for the "Cookies and Cream" dessert! Parking available in the adjacent garage and tickets validated for discount. Located at One State Street, 20th Floor, Hartford, CT. For reservations call (860.722.5161) or visit www.ontwenty.com

INDEX FUND PERFORMANCE

Here is a factoid one should always have in mind. Over the past 5 and 10 years, the total returns of index funds have ranked within the top half of all funds within their respective asset class as measured by Morningstar data (shown right) with respect to one large family of index funds. Two observations: 1) investing with index funds is a very sound strategy; 2) to outperform an index fund in its category is a very difficult task.

	Percentile Ranking		
Index Fund	**5 Yrs**	**10 Yrs**	**Category**
S&P 500	35%	43%	Large Blend US Stock
Small Cap US Stocks	20%	37%	Small Blend US Stock
Total International Stocks	23%	19%	Foreign Stocks
Total Bond	38%	40%	Fixed Income
REIT	21%	33%	REIT
Emerging Market	25%	37%	Emerging Markets

QUOTE: "Measure your wealth, not by the amount of your possessions, but by the absence of your needs." – Unknown

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