

Financial Market Newsletter 2nd Quarter 2009

U.S. Banks: Feeling Less Stressed?

By one important measure, the U.S. government's financial stress tests on major banks have already proven to be a success. Since the results of the stress tests were released a few weeks ago, financial firms have returned to private capital markets at a record pace to significantly boost their capital positions. During the first week of May, government regulators announced the results of the much-anticipated "stress tests," which were designed to rigorously examine how well the balance sheets of major U.S. banks could withstand a potentially more severe economic environment. Of the largest 19 banks, the regulators instructed 10 of them that an additional \$75 billion of capital would be necessary to adequately survive in such a scenario.

Stress-Test Transparency Instills Confidence

Despite the news that a majority of the nation's largest banks remained under-capitalized, investors generally greeted the results with enthusiasm. May ended up being the biggest month ever for secondary equity issuance (existing public companies issuing new shares), as U.S. companies sold more than \$50 billion of new stock to the public. Issuance was dominated by large financial firms, with roughly half issued by the 10 banks required by regulators to raise new capital. Along with asset sales and conversions of preferred stock, banks have already raised the bulk of the capital required as a result of the stress test results—with no additional assistance from the federal government. The ability of banks to return to access private capital markets at such a brisk pace is a dramatic turnaround from just two months ago, when new equity issuance would have been unthinkable.

Banks Still Facing Pressures

The return of banks to the private markets does not mean they are out of the woods yet. By all accounts, their loan books continue to deteriorate, and the extra capital will be important to help absorb growing losses on mortgages, commercial real estate loans and credit cards. The Federal Deposit Insurance Corporation reported delinquency rates on the entire book of bank loans and leases already hit a record high in the first quarter of this year. The stress-test estimates show that loss rates on the banking industry's loan books could reach more than 9%, resulting in \$600 billion of additional losses. No one can foresee whether the "more adverse" scenarios proposed by the regulators in their stress-test assessments will end up being pessimistic enough.

Investment Implications

Whether the regulator stress tests end up being accurate in estimating the exact magnitude of loan losses is less important than what they have already accomplished. Due to the transparency of a standardized capital adequacy test on the nation's major banks, investors felt more comfortable with an understanding of the potential downside of loan losses going forward. The subsequent investor confidence thus has allowed banks to boost their capital positions, and at the very least they will be in a better position to withstand whatever economic environment unfolds. The stress tests already have proven to be one of the least expensive and most successful policy initiatives to start moving the financial system away from government life support.

What you should take away from this

1. Since the results of US government stress tests on banks were unveiled in early May, major banks have raised capital in the private markets at a record pace to boost their capital position.
2. Banks are likely to face massive loan losses ahead BUT the post-stress-test confidence boost from investors has placed them in a better position to withstand whatever economic climate that unfolds.

Why You Should Consider Custodial Accounts

Custodial accounts were designed to gift assets to a minor in the form of investments in 1956 under the Uniform Gift to Minors Act (UGMA). This saved parents from the hassle of opening and paying the legal obligations of a trust. Changes were made in 1986 creating the Uniform Trust to Minors Act (UTMA) which enabled parents to gift not just cash or shares, but also tangible items such as real estate and artwork.

Unlike a 529 plan that restricts distributions for college purposes only, a custodial account can be used for any purpose as long as it benefits the minor. Also, investments choices are not limited to mutual funds or index funds, but can also include individual stocks, bonds, and CDs.

With recent negative returns from 529 age-based portfolios offered by most companies, investors turned their eyes towards custodial accounts. The custodial account gives investors the ability to make their own investment decisions: when to get in or out, and what to invest in with the assets set aside for that minor.

Reasons to Consider Custodial Accounts

529 Plans	Custodial Accounts
Capped at State Maximum	No Annual Maximum gifting rules may apply
Mutual Funds Only	Stocks, Bonds, mutual funds, ETFs, CDs
Can only be for Qualified College Expenses	Used for any expense if it benefits the minor
Can Only Rebalance once a year in most plans	Can make investment changes anytime

Is a custodial account right for you? Speak with your advisor today.

Question of the Month: SIMPLE IRA vs. 401(k)

Q: We are evaluating which retirement plan to implement for our business. What are the advantages and disadvantages of a SIMPLE IRA retirement plan versus a 401(k) retirement plan?

A: Both SIMPLE IRA and a 401(k) Retirement are both great options, it really just depends on what you want to get out of your company retirement plan. Here is a very basic breakdown of what each plan offers.

Eligibility

A SIMPLE (Savings Incentive Match Plan for Employees of Small Employers) IRA plan can be offered by businesses that have 100 or fewer employees, where as a 401(k) plan can be offered by businesses that have one or more employees.

Annual Contributions

A SIMPLE IRA allows employees to contribute up to \$11,500 in pre-tax salary deferrals or \$14,000 if age 50 or older. This year in your 401(k) employees can contribute up to \$16,500 in post or pre-tax salary deferrals or \$22,000 if age 50 or older. Like a Roth IRA, the Roth version of the 401(k) allows for post tax contributions (with significantly higher limits than a Roth IRA). Unlike a Roth IRA, employees with relatively high incomes can still make contributions.

Company Match

A SIMPLE IRA requires employers to either match employee contributions 100% of the first 3% of compensation (can be reduced to as low as 1% in any 2 out of 5 years.) or contribute 2% of each eligible employee's compensation (with a \$245,000 limit). A 401(k) does not require employers to match or contribute. New Comparability, also known as Age-Weighted, is a type of 401(k) plan design that maximizes the amount contributed to a select group (typically the business owner and other key employees) while minimizing the total

cost of employee contributions.

Vesting

A SIMPLE IRA requires all contributions to be immediately 100% vested. A 401(k) requires employee salary reduction contributions to be immediately 100% vested. With a 401(k), employer contributions may vest over time according to plan terms.

Plan Cost

A SIMPLE IRA is a low or no cost plan to the employer that does not require an annual IRS filing. A 401(k) is a low cost plan to the employer that requires an annual IRS filing, which is often provided by the 401(k) vendor. Based on plan design, a 401(k) may require employee discrimination testing.

Summary: This is a quick view of both types of plans and as each plan offers certain advantages and disadvantages, speak with one of our retirement plan experts before making a decision.



House committee approves bill restricting 401(k) advice to independent advisers

An influential House committee approved a comprehensive package of retirement legislation that includes a provision that would permit only independent financial advisers to counsel 401(k) participants on their investment decisions.

This bill merged two proposals that were

introduced this year: one made by Rep. Rob Andrews, D-N.J., focused on conflicted investment advice, the other sponsored by the committee's chairman, Rep. George Miller, D-Calif., would have required increased disclosure of fees and expenses in 401(k) plans.

Mr. Andrews' proposal essentially would prohibit employers from hiring brokers or registered representatives to serve as investment advisers to participants in the 401(k) plans they sponsored. "We think that investment advisers should only have one interest in mind, and that is the individual," he said during today's committee meeting. Brokers whose compensation has the potential to be influenced by the advice they provide, he added, may not always put 401(k) plan participants' best interests ahead of their own.

Now that the bill has been approved by the Education and Labor Committee, congressional leaders are beginning discussions to determine what the next step in the process will be before the legislation goes to the full House for a vote, according to a spokesman for the committee. Mr. Miller noted that the bill is still a "work in progress." But if the proposed bill is ultimately enacted, it could effectively nullify a January ruling by the Department of Labor and the Bush administration which allowed brokers and reps affiliated with financial services providers to serve as 401(k) advisers. "In the final hours of the Bush administration, the Department of Labor gave Wall Street a long-sought-after way to line their pockets at the expense of the account holder," Mr. Miller said during his opening remarks today. "They said that it's perfectly fine to recommend a product or investment because it will increase your income, not because it is the best for the worker." "Well, it's about time that Wall Street stop viewing workers' 401(k) accounts like a gold deposit to mine."

Just the Tax Ma'am:

Going green this year?

After a hiatus in 2008, the tax credit for non-business energy property is back in 2009 and 2010.

What does this mean for the individual taxpayer? Individuals can once again claim a nonrefundable credit for certain expenditures made during 2009 to increase the energy efficiency of their primary residences (IRC 25C). The credit is available on 30% of qualified expenditures and is capped at \$1,500 per taxpayer. Eligible items for the credit are split into two categories: Energy Efficiency Improvements and Energy Property Expenditures. What are some examples of qualified energy efficiency improvements and property expenditures??

1. Eligible Building Envelope Components:

MUST BE INSTALLED IN TAXPAYER'S PRIMARY RESIDENCE (vacation homes do not qualify). Additionally, the components must be reasonably expected to remain in use for at least 5 years. The manufacturer must also certify that the property meets the energy-saving criteria:

- Insulation systems that reduce heat loss/gain
- Exterior windows (including skylights)
- Exterior doors
- Certain metal and asphalt roofs

2. Qualified Energy Property:

- Electric heat pump water heaters
- Electric heat pump
- Biomass fuel stove
- High-efficiency central air conditioners
- Natural gas, propane, or oil water heaters
- Natural gas, propane or oil furnaces or hot water boilers
- Fans used in a natural gas, propane or oil furnace

As Paul McCartney once said, "Here comes the sun". In addition to the credits available above, there continue to be opportunities for taxpayers to qualify for the Residential Energy Efficient Property credit through 2016. This credit applies to certain expenditures for solar electric property placed in service during the year and includes items such as solar electric property, solar water heating

property, fuel cell property, small wind energy property and geothermal heat pump property. To qualify, the expenditure must be certified by the Solar Rating Certification Corporation (a nonprofit group) or a comparable entity endorsed by the state in which the property is installed. Unfortunately, expenditures relating to a swimming pool or hot tubs do not qualify for this credit.

Ask CPS FAQ:

Q: So, unemployment is up, Government spending is up and housing is still an issue... How can anyone say that we are out of this recession?

A: Median home prices have retreated to their historical norm, new claims for unemployment have declined, and the "TED" spread (a barometer of Bank lending health) has reverted back to historical norms. Leading us to believe that we are nearer to the end of this recession than the beginning.

Q: With the market still in flux, is the Money Market still the safest bet for my retirement monies?

A: If you wait for the headlines to tell you that we have reached new "low" in the market, you will have missed a once in a life time opportunity, considering how far the market had declined in the last 18 months. The last time we had an opportunity like this was the 1974 Bear Market.

Thank you for your many kind referrals!

Credits: Dirk Hofschire, MARE; Aaron Slokoff, Independent Press; Mark Bruno Investment News; Mike Riskin, CPS Investment Advisors; Derek Oxford, CPS Investment Advisors; Chas Smith CPS Investment Advisors; Bryan Mau, CPS Investment Advisors