

Market Returns

	November 2009	Year-to-Date		November 2009	Year-to-Date
DJIA	6.5%	17.9%	MSCI EAFE	1.8%	26.0%
S&P 500	5.7%	21.3%	MSCI Emerg Markets	4.3%	68.1%

November The market had an excellent month, and reversing recent trends, the domestic stocks led the broader foreign indices. As the recovery continues, the silver lining to the year's earlier carnage is that many equity mutual funds now have a "bank" of capital losses, realized through liquidations when investors ran for the exits during the crash, that can be used to offset this year's gains, and perhaps several years hence. Savvy mutual fund investors generally delay purchases until year-end capital gains are paid, so as not to incur taxes on gains they never enjoyed. This year, with most equity mutual funds holding realized losses, new investors will essentially get the benefit of these losses, i.e., be able to use them against future realized gains within a given fund, without having had to own the fund during its decline. *The Wall Street Journal* reported on November 30, 2009 that Dodge & Cox Stock Fund, one of our large cap value holdings, has a *negative* 23% capital gains exposure, which should insulate investors from taxable distributions for some time.

Vindication Asset allocators, adherents to Modern Portfolio Theory, had their mettle tested this year. The market's free fall from January to March left no asset class unscathed. Most of us were perplexed, and questioned this time-tested philosophy's soundness. Since early March, however, asset allocation has proven a winning strategy for the long-term investor. Year-to-date returns, the horrific first nine weeks notwithstanding, range from solid to extraordinary: High yield corporate bonds, 53%, investment grade bonds, 20%, municipal bonds, 13.5%, US stocks, 24.4%, emerging market stocks (this is not a typo), 74.3%. Sticking with our model, even when our emotions told us to do otherwise, increased our clients' exposure to the best sectors. When stocks bottomed in March, client portfolios fell below their target levels for equities. Following our model, we recommended selling fixed income holdings to buy stocks. The model worked.

Trendy Investing Following fashion trends may be fine for clothing and hairstyles, but not for investing. Many regretted buying into oil-related investments when oil was over \$100 per barrel. Several years ago, prominent pension funds, university endowments and large foundations adopted the "Yale University Model," which eschewed traditional asset classes in favor of hedge funds, private equity, real estate, timber land, and commodities, just as these highly illiquid markets began to collapse. Citizens Wealth Management has maintained its incremental approach to altering portfolio construction. We haven't jumped on trends, knowing that too often, mainstream investors join the current fad, *en masse*, shortly before its reversal. We may add new asset classes if it is prudent to do so, but not because something has become "fashionable."

Dubai The Dubai debt crisis caused a knee-jerk reaction that was muted but puzzling; the dollar and US Treasuries rallied, while gold plummeted. One conclusion; the dollar's safe haven status is still intact. Another result was heightened concern for emerging markets. While speculative markets always warrant caution, most emerging countries have followed prudent fiscal and monetary policies since the 1995 and 1997 debt crises in Mexico and Asia, respectively. Unlike Dubai, most emerging market countries are resource producers, low cost manufacturers, or both. Dubai is neither.

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