“So the last shall be first, and the first last.” It would be difficult to find a more apt description than this of the performance of the investment markets in 2008 and 2009. The last ten months of 2009 were like a mirror image of the preceding sixteen months. The start of 2009 continued the wildly volatile stock market decline of 2008 with the first six weeks of the year tacking on an additional drop of 25% to the 37% drop of 2008. However, starting with a 6.4% jump on March 10th, the S&P 500 moved in a virtual straight line upward from there to the end of the year. By year-end, the rebound had swelled to a 65% gain off the bottom and a total return of 26.5% for the year. At the start of 2009, few would have guessed the stock market would produce positive returns, let alone its second best year of returns since 1998! Nor did Foster & Motley make that guess, but we did point out in the year-end 2008 Review & Outlook that, “…massive valuation compression has set the stage for better returns to come. There are tremendous investment opportunities awaiting the patient investor.” As it turned out, less patience was required than we thought.

Among asset classes, the same reversal of fortune theme played out as the first from 2008 (in performance) turned into the last in 2009. US treasuries, which were the best performing asset class in 2008 when a broad index of treasuries returned 14%, turned into the worst in 2009 with a return of -4%. By the same token, emerging market stocks went from worst in 2008 (-53.3%) to best in 2009 (+78.5%). On the bond side, the worst category in 2008, high yield bonds (-26.4%), became the best category in 2009 with a return of 57.5%. It’s easy to see why investors can find themselves whipsawed if they chase from asset to asset trying to catch what’s working only to find themselves in what’s no longer working. It’s far better, in our view, to have a discipline and stick to it.

Here are the numbers for the year:

<table>
<thead>
<tr>
<th>Benchmark 2009 Total Returns</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500 (large US stocks)</td>
<td>26.5%</td>
</tr>
<tr>
<td>Dow Jones Industrial Average</td>
<td>22.7%</td>
</tr>
<tr>
<td>NASDAQ Composite (mostly tech stocks)</td>
<td>45.4%</td>
</tr>
<tr>
<td>Russell 2000 (small stocks)</td>
<td>27.2%</td>
</tr>
<tr>
<td>Wilshire 5000 Index (total US stock mkt)</td>
<td>28.3%</td>
</tr>
<tr>
<td>EAFE (established international stocks)</td>
<td>31.8%</td>
</tr>
<tr>
<td>MSCI Emerging Markets Free</td>
<td>78.5%</td>
</tr>
<tr>
<td>Merrill Lynch US Master (taxable bonds)</td>
<td>5.2%</td>
</tr>
<tr>
<td>Merrill Lynch Municipals 1-12 Years</td>
<td>7.2%</td>
</tr>
<tr>
<td>NAREIT Equity REIT Index</td>
<td>26.1%</td>
</tr>
</tbody>
</table>

Federal Estate Tax

by Amy Thomas, CPA®

Congress did not act before year-end, resulting in some major changes to the federal estate, gift and generation-skipping taxes in 2010. This year the federal estate tax rate is zero, meaning estates of any size will pay no federal estate tax. Furthermore, rules for stepped-up cost basis have significantly changed and may result in a limited step-up in basis for larger estates. The generation-skipping tax has also dropped to zero. The gift tax rate has been reduced from 45% to 35%; however, the lifetime gift tax exclusion remains at $1M. The annual gift exclusion amount remains unchanged at $13,000. Any gifts over this amount would require you to file a gift tax return.

If no further legislation is passed, the estate tax comes back in 2011 at a higher rate, and with a significantly lower exclusion amount than those
Federal Estate Tax, continued...

in 2009. The maximum 2011 tax rate will be 55% (45% in 2009) and the exclusion amount will only be $1M ($3.5M in 2009). The generation-skipping tax will also return, and gifts will be taxed at the highest estate tax rate.

It is unclear how Congress will address any of these taxes, and whether or not they will make revisions. There is a possibility that revisions made mid-year could be retroactive to the beginning of 2010. We will continue to monitor congressional talks, and will keep you informed as developments occur. At some point, a review of your estate plan may be necessary. If you have immediate questions or concerns we recommend you contact your estate planning attorney. Of course, you can also contact us with questions.

The Lost Decade by Mark Motley, CFA

Ten years ago, in January of 2000, the decade of the 1990's had just ended and the S&P 500 Index had just produced a ten year compound annual return of 18.2%. Moreover, it had just completed an unprecedented run of five years in a row of returns in excess of 20% per year. Many investors had begun to expect stock market returns of 15% or more per year in the long run. In our Review & Outlook at the time, we quoted Warren Buffett saying “People aren’t going to average 15% or anything like it in equities”. Our own comment: “The long term return [for stocks] from this point is highly likely to be well below the unusually high returns experienced these last 15 years or so.”

In the ten years that followed (and that have just ended), the compound annual return of the S&P 500 was -0.95% per year. Many investors are now ready to give up on stocks and money flows are surging into bond funds.

Markets can be highly variable in the short run, but produce relatively more consistent results in the long run (obviously, “the long run” in this context means periods quite a bit longer than ten years). This tendency for market returns to even out over time actually has a name: “mean reversion”. This implies that after a five or ten year period of well above average returns, the next five or ten years are likely to produce below average returns so that longer term returns “even out”. And vice versa: intermediate periods of unusually poor returns are likely to be followed by periods of better than average returns. Here is a chart of stock compound annual returns by decade:

Two facts leap from this data. First, the calendar decade that just ended was the worst ever for US stocks (one of only two that were negative). And second, we see that tendency toward “mean reversion”.

(continued on Page 3)
The Lost Decade, continued...

In fact, we find that for the seven best decades in which stock returns were more than 10% per year, the average return in the following decade was only 6%, which is below the average for all decades of about 9%. Conversely, for the seven worst decades where stock returns were lower than 7%, the average return in the next decade was 11.6% per year, a well above average return.

Since the decade that just passed was the worst calendar decade for US stocks ever, if other things were equal, one might expect better than average returns over the next ten years as a whole.

However, things are never equal, and market returns ahead are likely to be hampered by today’s less than attractive valuations. The dividend yield of the S&P 500 is only 2%, whereas it has averaged closer to 3% in the long run. Regardless of the rate of dividend growth over the next decade, if the market’s dividend yield climbs to 3% over the period, that valuation adjustment would shave 4% per year off whatever returns would otherwise have been achieved.

Moreover, future dividend growth (and earnings growth) for the market is highly uncertain given government policies resulting in “unfulfillable entitlement promises and unsustainable budget deficits” (George Will). In fact, just this month, the firm Eaton Vance made the point that if no changes are made to current law, in just nine years, 100% of the federal budget will be required to pay just Social Security, Medicare, and interest on the federal debt! Clearly, with that kind of train wreck looming, changes will be made, likely to include higher tax rates, even more borrowing, and perhaps higher inflation between now and then. Higher tax rates translate to lower growth, more borrowing is likely to result in higher interest rates at some point, and both reduce stock returns.

Extreme negative sentiment about an asset class is generally a harbinger of better returns ahead (and nothing creates negative sentiment like the worst calendar decade in history). Many people may be too negative in their long term outlook for stocks, and it’s unlikely that the “lost decade” will be immediately followed by another decade of such unusually poor returns. On the other hand, valuations and policy issues are such that we find it difficult to expect stock returns over the next decade to be well above average either. We would also expect significant cross currents along the way (i.e., volatility). However, volatile yet middling returns in the 2010’s, if achieved, should still be a welcome improvement from the volatile yet negative returns of the decade just past.

Gifting to Haiti by Amy Thomas, CPA®

The recent disaster in Haiti has resulted in some questions about charitable gifting. Here are some basic tips to keep in mind when gifting to charities, especially in times of disaster. Avoid newly formed charities and those that have never worked in the disaster area. Also avoid giving directly to people claiming to be a victim, telemarketers, and unsolicited e-mails. Several new websites have been created since the Haiti disaster and some are scams - be careful. Research your charity of choice and review their official website. There are many charities working in Haiti and most have different goals. Some are providing food, shelter, or immediate medical needs but others are focused on the long-term rebuilding effort. If you consider making a gift of actual supplies, verify that the charity has the ways and means to transport the donations to the disaster area. Pick the charity that matches your goals and designate your gift for this specific disaster if that is important to you.

Several companies are offering to match retiree and employee donations to Haiti. For example, Procter & Gamble is matching donations up to $250,000 to their Haiti Relief Fund that are made by March 1, 2010.

(continued on Page 4)
Gifting to Haiti, continued...

There have been some recent changes in the tax law that may impact your charitable giving. The tax provision allowing qualified charitable distributions from an IRA expired at the end of 2009. This provision allowed individuals age 70½ and older to exclude from income distributions made directly to a qualified charity. Congress may extend this provision but at this point they have not.

Just signed into law on January 22nd, cash donations to a qualified charity for the Haiti disaster made by March 1, 2010 can be deducted on your 2009 tax return. You may choose whether to claim this deduction in 2009 or 2010, depending on what is most advantageous to your situation. If you need help with charitable donations or have any questions regarding this information, please contact us.

Foster & Motley - On the Move

Foster & Motley is excited to announce that we will be moving our offices this summer. In December we signed a lease for first floor space at Redstone of Kenwood, located at 7755 Montgomery Road. The facility is a five story office building located about a block south of the Kenwood Towne Centre.

Our decision to move was precipitated by favorable lease rates currently available for commercial space, affording us the opportunity to upgrade our facilities, expand our client meeting area, and provide for future growth. Our new office will be larger than our current space and will also be located all on one floor, allowing for more efficient work flow. The building also features a covered parking garage, which we believe clients will appreciate during periods of inclement weather. We will notify you once our move-in date is finalized, however we believe our target move in date will be August 1st.

News & Notes

Third party wire requests. Effective February 1, 2010, Schwab will randomly call clients who have requested a third party wire to verify the accuracy of the request. Schwab’s new policy is part of a firm-wide effort to assure that client assets are protected.

Mark Motley, CFA, was featured in an October, 2009 The Wall Street Transcript article entitled “Exceptional Opportunities in the Current Market”. Mark discussed the firm’s focus on valuation, growth, quality and dividend yield, explaining that there still appear to be individual opportunities among a number of larger, higher quality companies.

Paul Staubach, CPA, CFP®, and Tony Luckhardt, CFP® are attending an 18 week in-depth estate planning series put on by the Cincinnati Bar Association, and featuring Bill Graf and Mark Stiebel of Graf & Stiebel Co., LPA as instructors.

Dave Foster, CPA, CFP® recently attended the week-long Heckerling Estate Planning conference, presented by the University of Miami School of Law. This is one of the nation’s leading conferences for estate planning professionals, covering the latest planning techniques.