



VOLUME 2, ISSUE 4

# THE (NOT SO) ALMIGHTY DOLLAR

JULY 16, 2008

MONTHLY NEWSLETTER AND UPDATE

Dear Valued Clients, Friends and Professionals,

I hope everyone had an enjoyable fourth of July. I did. At a family event I even found a rationale for optimism about long-term prospects for growth in the U.S.

Until the picnic on the 4th I was mired in low grade despair because I could not imagine what would stimulate our economy in the future other than the building and staffing of assisted living complexes for me and my fellow baby-boomers. In my view, the demographic bulge that is my generation has accumulated all of the "stuff" we need including PCs and cell phones. I was stuck on the idea that without domestic manufacturing the next 30 years or so would be a shrinking economy at home.

Over potato salad and corn on the cob my cousins discussed replacing the oil furnace with a heat pump and the 4X4 with a hybrid. It occurred to me that the present gas and oil squeeze could spark a substantial replacement of our infrastructure.

This doesn't take away the immediate pain of General Motors and the price of groceries. Nevertheless, converting our country to fuels that are not fossil based is going to be enormously expensive. That is what growth is all about. Perhaps the workers on the Ford truck assembly line will be able to find work in alternative energy fields. Down the road, are there jobs and prosperity for those involved in retrofitting houses for electricity, heating and cooling that doesn't depend on a hydrocarbon? Maybe so, maybe not. At any rate, as I drove home I felt optimistic for reasons other than the really excellent sausage sandwiches and pleasant company of my extended family.

Best regards,

Jeff Sprowles, CFP®



## Intra-Quarter Update

- S&P 500 — domestic large cap
  - 6/30 to 7/15 ( 5.0%)
  - YTD (16.3%)
- Lehman Intermediate Gov Bonds
  - 6/30 to 7/15 0.8%
  - YTD 3.21%
- 90 Day U.S. Treasury Bills
  - 6/30 to 7/15 0.7%
  - YTD 1.7%
- Emerging Markets ETF (EEM)
  - 6/30 to 7/15 ( 6.6%)
  - YTD (13.5%)
- Jeff's Current Stock Outlook
  - 87.5% of target

## MARKET COMMENTS

Please note that the stock target has gone up this month. The Price/Earnings ratio of the S&P 500 Index is below 15. The real yield compared to that of 5 year Treasuries is out of whack. This suggests that interest rates will go up, stocks will go up or corporate earnings go down or some combination thereof.

Short term timing indicators for the S&P 500 as well as several of the ETFs I use are suggesting that we are close to the end of a down cycle. From a valuation point of view several of the ETFs I use have very attractive P/Es for their growth rates. These include:

- IWD — large cap value — P/E under 13
- EZU — Europe — P/E under 10
- FXI, EWH — China and IFN — India — P/E under 15
- EEM — Emerging Markets Index and EWZ — Brazil — P/E under 13

The market drop since last fall has been really painful and I will not hesitate the next time my matrix turns south. That said, all stocks in client portfolios are funded with long term money and we should hit our long term goals. The current buying opportunity should help everybody and especially new deposits.

### JEFF'S PICK:

**EWH — iShares MSCI Hong Kong Index**

Until now Jeff has used FXI — an ETF buying the 25 largest H class shares available to foreigners to invest in China. To diversify, Jeff is looking to add EWH, an ETF with broader exposure to Chinese stocks including some real property.



Certified Financial Planner

Herbert and Alicia Jarndyce are worried that 60% of their portfolio invested in Exxon Mobil stock may be risky. After they bought a Prius it occurred to them that big oil may have a peak in its near future. If they sell XOM they will incur an enormous capital gains tax because Alicia inherited the shares in 1970 and the \$80 stock has a basis of \$2. Jeff Sprowles and Associates LLC suggested they consider donating the ExxonMobil to a charitable trust so they can diversify while deferring capital gains taxes.

The Jarndyces met with Jeff to discuss the best way to give their shares. Jeff proposed a Charitable Remainder Trust. CRTs come in several types. In the Jarndyces case, Jeff sug-

gested they consider a charitable remainder unitrust with their attorney. The Jarndyces would deposit their Exxon shares to a trust, the trustee would sell the stock and incur a \$78 per share gain but not pay tax on it immediately because a charity will eventually enjoy principal. The Jarndyces (or beneficiaries they name) would receive income from the trust for as long as they are living or a specified period of time. At termination of the trust, the charity receives the balance of principal. There are several benefits to a CRT. The Jarndyces won't pay an



immediate capital gains tax on the donated shares even if the trustee sells the shares after deposit. Beneficiaries pay tax on their distributions and any amounts in excess of dividends and interest earned by the trust will be taxed as a capital gain until the gain realized on the sale has been distributed. They get an income tax deduction for the fair market value of the remainder interest to charity the calculation of which is based on who gets income and for how long. In addition, the value in their estates will be zero if they keep the

income and the value of the life interest if they give the income to somebody else. It is important to note that the contributions made to a CRT are irrevocable; but the donors may retain some control over the way the assets are invested, and may even switch the eventual principal distribution from one charity to another.

They also will probably get their names listed in a brochure issued by Harvard, Wellesley and The First Methodist Church of Springfield.

Jeff Sprowles and Associates offered to discuss this with the Jarndyces attorney and model the options available to see if a CRT fits their investment, cash flow, tax and estate plans.



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**WHAT DOES THE PRESIDENTIAL ELECTION MEAN FOR THE STOCK MARKET??**

To the right is a table illustrating performance in the third year of a presidential cycle to complete the discussion of the topic. The average total return from 1935 to 2007 is 21.8% which compares favorably to the 13.0% for all years from 1932 to 2007. Perhaps there is a hedge fund somewhere that invests 100% in stocks during the third year of a presidential cycle and in short term bonds and CDs during the other three years.

Note that of the 19 samples in the chart only 4 are in single digits of which only one is negative. You may recall from an earlier essay on this topic that the election year tends to be above average except in lame duck years. Of the 4 all but 1947 preceded lame duck election years. I include 1939 because at the time 1940 was going to be a lame duck year.

The current outlook is not good from a presidential cycle point of view. Since last month the P/E of the S&P 500 Stock Index has declined to the 6th decile in my data base, which is neutral. The real yield on the S&P 500 has increased to 1.9% compared to negative 1.6% on 5 year Treasuries. This suggests some combination of increase in stocks, lower corporate earnings and higher interest rates. Higher interest rates are definitely in our future but perhaps not for a little while. Although traffic on the Norfolk & Southern railway is picking up, I suspect reported corporate earnings will go down for a little while. Nonetheless I have increased my stock target. Investing in bonds or cash is a negative yield at the moment.

Year	Tot Ret	Prev P/E
1935	47.7%	24.0
1939	-0.4%	10.0
1943	25.9%	7.7
1947	5.7%	18.8
1951	24.0%	7.3
1955	31.6%	10.1
1959	12.0%	12.2
1963	22.8%	21.7
1967	24.0%	18.0
1971	14.3%	15.6
1975	37.2%	11.8
1979	18.4%	8.3
1983	22.5%	7.6
1987	5.2%	14.2
1991	30.6%	14.9
1995	37.4%	21.6
1999	21.0%	24.3
2003	28.7%	46.2
2007	5.5%	32.5