Quarterly Report

Union Financial Partners (415) 563-3000

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What's New?

Our website has been revised. Please visit www.ufpartners.com to view our site.

aterranova@ufpartners.com

Contents

Investing in a Financial Planning Context: Success or Failure?

Ann Terranova, CFP™

How do you define success or failure in your investment program? When your account goes down that must be failure, right?

Evaluating investment success or failure in a financial planning context means analyzing if, or by how much, a financial plan is off track. This requires updating an existing plan and a new look at the numbers and the assumptions in the plan. This is the work of integrating a comprehensive personal financial plan with investment management.

In defining success or failure in investment management you could apply these three tests:

First Test: Did I make money?

Second Test: How did my account perform relative to what's happening in the markets?

The Ultimate Test: Am I (still) on track to achieving my financial goals?

First Test: Did I Make Money?

In the midst of the financial crisis and global recession, most people's investment accounts this past year did not make money. A fall in value of 20% or even as much as 45% is significant by any measure. Add to that the tendency that people have to extrapolate recent events into the future, to think stock prices will continue to fall for ever, and we can understand the cause for alarm.

In 2008 the S&P 500 Index fell 37%. In the first quarter of 2009 the S&P 500 fell an additional 11.01%. From the market (S&P 500) peak of 1561.80 on October 12, 2007 to the recent low of 676.53 on March 9, 2009, the Index fell 56.7%. Smallcap, value, growth, and international equities all experienced similar results. Most people did not make money in this market.

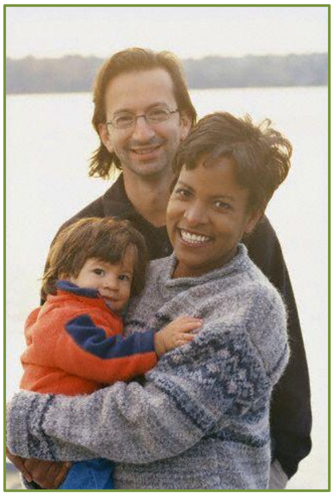
In the face of this experience it may be difficult to remember that the stock market ever went up, or to

Continued on Page 2

Multigenerational Wealth Management

Multigenerational Wealth Management is the process of implementing asset accumulation and consumption strategies over a long period of time, a period of time that encompasses the needs of successive generations of individuals in a family.

Because the time line of investments is an essential factor in determining the composition of investments in a portfolio, the needs of multiple generations are taken into consideration. Proper investments as well as business, estate and income tax planning enhance multigenerational wealth.



Investing in a Financial Planning Context: Success or Failure?

Continued from Page 1

think that they will ever go up again. Stock prices do go up and down. When the stock market goes up, people extrapolate *that* trend into the future, and euphoria sets in. This is the nature of markets and the psychology of markets.

Account values falling over the past 18 month period leads to failure by the first test. But we are really left needing more information. If you have a diversified portfolio of stocks and bonds, the total account value does not tell you whether your bonds failed to make money or just your stocks. It does not tell you whether your financial goals are more or less likely to be realized now than they were 18 months ago.

Managing investments to succeed by the first test can lead to certain failure by the ultimate test. That is, investing 100% in fixed income, cash/equivalent investments or CD's can result in an account that does not fall in value. However, this almost always leads to certain failure in meeting long-term financial goals.

The Second Test: How Does Your Portfolio Performance Compare With "The Market?"

It is useful to compare a portfolio's return with a standard benchmark of the market such as the S&P 500. You can see how your portfolio performed relative to the S&P 500 by looking at the portfolio performance statistics on your Quarterly Portfolio Performance Report.

A high risk portfolio should fall in close to the S&P 500. A more conservative portfolio should have a much better return in a falling market, even if that return is still negative. This information is used to make decisions about whether or not your portfolio needs to be reorganized. Your Quarterly Portfolio Performance Report provides us with this information.

Your Risk-Targeted portfolio is composed of equity and bond investments designed to capture market returns and is directed specifically towards your financial goals and the time horizon in which you plan to meet those goals. That is, an aggressive portfolio may be appropriate for your long-term retirement goals while a more conservative portfolio is appropriate for intermediate-term goals.

Take a look at the composition of your portfolio and you will find the percentage of your portfolio that is in bonds, not stocks. The bond market has also suffered in the credit crisis. However, bonds are debt securities, pay interest, and are (short of default) redeemed at face value upon maturity. This portion of your portfolio represents money that is not "in the stock market" at all.

An investment portfolio's success needs to be evaluated in terms of "how markets work" in general. Diversification is still an

Continued on Page 3

You can have an account that never falls in value by keeping your money in cash investments like CD's and short-term bonds. The problem, however, is that this type of winning can easily leave you failing to meet your long-term goals.

The time horizon associated with an investment portfolio is an essential factor in determining the portfolio's investment composition.

Investing in a Financial Planning Context: Success or Failure?

Continued from Page 2

important aspect of portfolio management. The potential for higher returns from the stock market over time underpins the assumptions that form the basis of financial modeling, including the risk of loss.

For an example of how diversification works, consider $100,000 invested for 10 years at 4% resulting in a balance of $149,083. The same $100,000, spread among five asset classes with results varying from 15% to -100% (completely lost) over the same ten year period creates a significantly superior result (see sidebar) of $195,895.

Maintaining a diversified investment portfolio through a crash cycle is both sensible and statistically sound. Even at a 45% loss, portfolios can be expected to recover over time. As the "Time to Recover" chart illustrates (see sidebar), a move to cash following a downturn in the market can prove to be a disaster in terms of recovery.

Upmarket returns are just as dramatic, if underreported, as crashes. Dimensional Fund Advisors (DFA) recently published a report showing the worst rolling one year markets in history. This report shows that the worst one year return ever was July when the S&P 500 Index fell 67.6%. The return in the year following that was +162.9%. The 3 year return was +39.3% average per year. For a more recent example, the year starting with October 1973 ended with the S&P 500 Index down 38.9%. The subsequent one year return was +38.1% and average annual 10 year return was +15.6%.

If your return makes sense in relation to the risk level of your portfolio and a benchmark index of the market, then you will benefit through periods of market gains as you have weathered this period of market decline.

The Ultimate Test: Am I (Still) On Track To Meeting My Financial Goals?

The ultimate test, though, is whether you are on track towards meeting your financial goals. These financial goals often include maintaining a comfortable lifestyle in retirement, charitable and other family wealth management goals. In your financial plan, these goals are quantified by how much and when. An example of a clearly-defined financial goal is: "My goal is to spend $80,000 per year adjusted for inflation for the rest of my life."

Continued on Page 4

Beginning Amount	Rate	Ending Amount
$100,000	**4%**	**$149,083**

$100,000 invested at 4% for ten years becomes $149,083 (above). The same $100,000 spread among 5 investments with widely varying results (below) becomes $223,726

Beginning Amount	Rate	Ending Amount
$20,000	15%	$88,804
$20,000	10%	$54,151
$20,000	5%	$32,940
$20,000	0%	$20,000
$20,000	-100%	$0
$100,000		**$195,895**

Asset Recovery Time After 45% Loss

Rate of Return	Years
2%	30
3%	20
4%	15
5%	12
10%	6
15%	4

Roth IRA Conversions

You can take advantage of lower account values by converting your IRA to a Roth IRA.

You can make the conversion in 2009 if your Adjusted Gross Income is less than $100,000 whether married or single.

Otherwise, you can make the conversion in 2010 regardless of your income level. An added bonus – you can pay any tax due over a two year period!

Once converted, you will never pay tax on those funds again. Depending on tax rates, investment returns and the amount of time before withdrawal, this strategy can add significantly to your retirement income.

Investing in a Financial Planning Context: Success or Failure?

Continued from Page 3

Accumulation Stage

If you are in the accumulation stage in the wealth management process, you are a number of years away from retirement. Your goal is to build wealth as efficiently as possible. Your portfolio is probably on the aggressive side. The best thing you can do is to continue adding to your investment portfolio though the crash cycle.

Statistics indicate that this is exactly what most people are doing. As the market went from bad to worse last year, nearly all active 401k participants who contributed in the third quarter, continued to contribute at a steady rate[1].

Consumption Stage

Maintaining a comfortable lifestyle "in retirement," indeed, maintaining a comfortable lifestyle at all right now, whether you are in retirement or not, is a challenge.

Most people, in response to the financial crisis, have reduced spending, cutting back on "extras" and delaying major purchases. Personal consumption spending contracted 1.9% during 2008 and continued to decline through the first quarter of 2009[2].

The personal savings rate increased to 4.2% in February of 2009[3]. This is astonishing when you consider that the savings rate for the past 20 years has been near zero.

People have responded to the slowdown by de-leveraging their personal balance sheets, paying off credit card balances, refinancing their mortgages, and building cash reserves. Money market fund balances grew by more than $700 billion during 2008. For the first time on record (since 1952) US consumer credit growth was negative in Q3 2008[4].

All of this is extremely healthy personal financial behavior. It may have been driven by fear, but it's the right thing to do.

The rule of thumb for consuming investments in retirement is a sustainable withdrawal rate of 4%. A number of factors have a bearing on this withdrawal rate and a comprehensive financial plan can determine the appropriate rate for each person.

Many experts recommend cutting back on this withdrawal rate when the market is bad and loosening the purse strings when times are good. It seems that the automatic response people are having to the economic downturn is consistent with complex portfolio consumption strategies.

Conclusion

To evaluate your investment program it is necessary to consider more than the rise or fall of your account's value . You need to understand the market environment and, most importantly, financial planning considerations. This includes targeting a portfolio to meet specific personal financial goals. Actual attainment of financial goals is the ultimate test of success.

NOTES

[1] Pensions and Investments 4/20/09

[2] Bureau of labor Statistics

[3] Federal Reserve Board

[4] FMRCo (MARE) as of 1/31/09