QuarterNotes
FIRESTONE CAPITAL MANAGEMENT, INC.
JACK M. FIRESTONE, CFP
CAROL G. KAUFMAN, CFP
CARLOS A. CARBONELL, CFA
www.firestonecapital.com
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**Stocks Bounce Back**

*Stocks continued their recovery into the fourth quarter. The Dow Jones Industrial Average and S&P 500 both rose 6%. The Russell 2000 index of smaller stocks added 3.9%, and International returns grew by 2.2%. Gold continued its move, increasing 8.6%. Emerging markets were up by 8.5%.*

**Annual ADV Offer**

*Each year the SEC requires that we notify clients when we are updating our ADV Part II. If you would like a copy of the updated form, please call the office. We will be happy to send one out to you.*

1500 San Remo Ave.
Coral Gables, FL 33146
Tel: 305-669-2119
Fax: 305-669-1976
jack@firestonecapital.com
carolk@firestonecapital.com
carlos@firestonecapital.com

# Worst Market Decade Not So Bad For Some Investors

As the champagne corks popped to welcome the New Year, investors breathed a sigh of relief for having survived the year and the decade. After a rocky start, the stock markets rebounded, posting a 59+% gain from the awful bottom on March 9. The 2000-2009 decade finished as the worst-performing decade ever, even worse than the Depression Era 1930s. The S&P 500 Index finished the decade 24% below its New Year's 2000 level. The Dow fared better, but still suffered a 9.3 % loss for the decade.

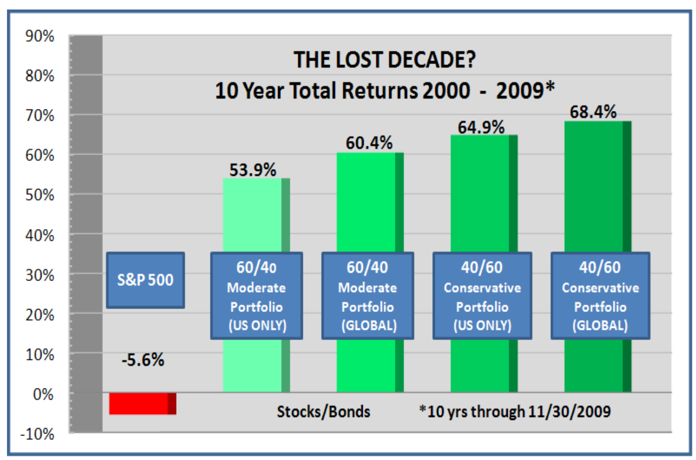
Was this truly a lost decade? Not for all investors. Numerous investments did well: bonds, gold & commodities, emerging markets, and many alternative strategies. Investors who persevered and maintained exposure to other asset classes -- even while holding a substantial allocation of stocks-- posted considerably better returns than the market indices.

Well-advised clients typically hold much more diverse portfolios than a single stock index. Therefore, historical returns from diversified portfolios must also be considered for comparison. Using Dow Jones composite portfolio indexes, we compared portfolios composed of both domestic and international stocks and bonds to the all-stock S&P 500 with dividends reinvested. The historical data shows that holding a 60/40 portfolio would have returned between four and five percent annually. That translates to around a 54% total return over the 10-year period. It appears that diversified investors didn't do so poorly after all, and many experienced portfolio growth.

So what will 2010 bring? Likely slow economic growth as the stimulus packages begin to wind down. We may see a surge of inventory rebuilding, but unemployment will be stubborn and slow to correct. Without jobs growth, consumer demand will remain weak. Even with these issues, the economy is expected to grow, though modestly.

Feeling the sting from the market's volatility over the last eighteen months, many investors are anxious about committing new dollars in such uncertain times. Inflation has been in check, and the prices of many goods and services have declined. Certificates of deposit, bonds yields, and money markets are at absurdly low rates. But investors who have committed to long-term certificates of deposit or Treasury bonds to try to escape market volatility may find that their returns are unlikely to maintain their purchasing power if inflation increases.

So what do we recommend for 2010? Maintain a diversified portfolio, rebalance as needed, look for assets or new investment strategies to improve the benefits of diversification, and when in doubt take advantage of dollar cost averaging.




Here are some steps to consider:

1) Mentally prepare yourself to expect volatility. Markets always go up and down. No one reliably times the markets.

2) Determine your commitment to stocks this year and plan to invest it.

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### Other Notes

**No Quick Fix:** Minutes from the last Federal Reserve Open Market Committee note that the Fed believes it wil take 5-6 years (from now) for the US economy to return to a growth, employment and inflation level consistent with the Fed's goals. *Source: Federal Reserve*

**Setting Records:** During fiscal 2009 the Treasury collected $2.1 trillion of tax receipts and spent $3.5 trillion, resulting in a $1.4 trillion deficit, an all-time record. *Source: US Treasury*

## Inflation and the Bond Markets

The Federal Reserve current policy of keeping short-term interest rates at basically zero is prompting concerns about inflation. "Cheap money" can create inflation because the excess liquidity allows increased demand for goods, services, and assets. The increased demand can force prices to rise. Nonetheless, inflation forecasts for 2010 remain in the modest 2% range. Because the economy is not operating at anywhere near capacity, firms have a limited ability to raise prices. Another factor limiting inflation is the reduction of consumer debt. This de-leveraging cycle is likely to continue as high levels of unemployment remain with us for several years.

Even with the tremendous expansion of the money supply by the Fed, banks are not lending aggressively. It is bank lending that acts as a multiplier, because lending increases the money supply throughout the economy. Instead, banks are holding on to the money created by the Fed to repair their balance sheets, which suffered during the recession.

Concerns about inflation's negative effect on the bond market are not unfounded but they are more about inflation expectations than about an imminent spike in interest rates by the Fed. Without Fed action, we have seen a rise of about 1/3% over the month of December in Treasury bond yields from 2-30 years in maturity, but with 2 year Treasuries priced at 1.08%, rates are still quite low.

*(Continued from Page 1 Column 2)*

3) Dollar cost average by investing on a periodic schedule, regardless of market levels.

4) Stay in touch with us so we can adjust your portfolio allocations to address your concerns regarding your goals, risk tolerance, and expectations.

We are always open to exploring new investment ideas as well as constantly tweaking the portfolio for macroeconomic events such as inflation, rising interest rates, dollar devaluation, etc. Consistent dialogue will help us manage your portfolios more effectively.

| Index | Close on 12/31/2009 | YTD % Change |
|---|---|---|
| Dow Ind. | 10428.05 | 18.80% |
| S&P 500 Index | 1115.10 | 23.50% |
| Nasdaq Comp. | 2269.15 | 43.90% |
| Russell 2000 | 625.39 | 25.20% |
| MSCI EAFE | 1580.77 | 27.70% |
| 10Year Treasury | 3.83% | |

### Follow-up on Roth Conversions

In our last issue we discussed a change in the tax laws for 2010, which allows conversions from a traditional IRA to a Roth IRA without regard to income limitations. Although it is appealing that a Roth IRA can grow without paying taxes on the gains and does not require minimum distributions at age 70½, certain considerations and assumptions make the decision a difficult one:

- Ordinary income tax must be paid on the conversion amount, and it is best if taxes are paid with non-IRA funds because paying the taxes out of the IRA reduces the benefit of the conversion by the amount of the taxes paid.
- Roth IRAs incur penalties if distributed within five years.
- You lose the growth on your assets used to pay taxes rather than deferring the taxes into the future.
- Assumptions need to be made about future tax rates and taxable income.

Generally speaking, the longer a client has until IRA withdrawals start, the more advantageous the Roth Conversion. For clients with sufficient assets without counting on IRA withdrawals, a Roth Conversion may make sense. In this case, the Roth IRA Conversion prepays the income taxes for the heirs and eliminates taxes that would be due when the IRA distibuted. Further, the estate value is reduced by the sum of the taxes paid when converted. However, if the estate exceeds the unified credit amount, the Roth will still be counted in the estate and taxed at rates then in effect.

**Happy New Year**
All our best wishes for a healthy, happy, and prosperous New Year.