



Fee-Only Portfolio News

A Quarterly Summary of Events and Changes

April 2008

Economic Woes Ahead? By Peyton

The recent market declines...what do they mean to you? A signal to get more conservative to prepare for a possible recession? The emergence of a buying opportunity as stocks have become cheaper? Remember the basic tenets of our asset management philosophy: deeply diversified long term strategists. Our main objective is to outperform, long term, by resisting the temptation to react to short term "noise".

Our portfolios are designed with a 12 month loss threshold. This means that, given 12 months, portfolios should recover to within these loss thresholds. This can be hard to stick to, but remember that fear should never be allowed to rule the day.

Right now, stocks look cheap when you compare prices to the earnings of the company. These measurements, of course, may be skewed, because recent corporate earnings have been so high compared to historical norms. Earnings going forward may justify these new lower prices...it hinges on whether we enter a recession and how deep it is.

So what action can we take now? The most important tactical element of our management is re-balancing. Every time the portfolios deviate substantially from their target allocation, they

are re-balanced. This translates into buying more stocks the cheaper they get. Also, remember that as interest rates decline (in response to slowed economic activity), our bond holdings enjoy price support to counteract the stock market declines. Patient investors who stick with this plan enjoy superior long-term results.

As the economic and market environment unfolds, we will continue to re-analyze valuations in light of a range of economic scenarios, to help us identify at what point we would want to over-weight stocks in our balanced portfolios. That point has not happened yet, but given the level of emotion, and the extent of recent declines, it is possible it could happen quite quickly. If stocks decline further, and present a compelling case for stocks versus bonds, we will probably be early, as hitting the actual bottom is luck as much as anything.

As usual, it is unclear what will happen next in the world. We contend that if we maintain our investment discipline, and focus on a multi-year time horizon, we should find good results. Recently proposed economic stimulus packages could put us back on the road to the slow-growth, low-inflation environment that is conducive to solid returns in a well-allocated portfolio.

TIME IN THE CORNER

Taxes 2007 & Beyond

Lets take a look at upcoming tax law changes, shall we? IRA deductions remain limited to \$4,000, unless you're over 50, in which case that increases to \$5000. In 2008 that increases by \$1000 (to\$5k &\$6k), and then in 2009 they begin applying a COLA for future increases. 401(k) and 403 (b) participants can put away \$15, 500, those over age 50 can defer \$20,500. The Personal exemption is up \$100 to \$3400. High income taxpayers (above \$156k) face falling allowable itemized deductions and personal exemptions due to their high income. AMT exemptions have been increased in 2007 to exempt more people from owing this tax.

Starting in 2008, capital gains rates have fallen for the lowest bracket from 5% to 0% and remains the same for the 10 & 15% maximum cap gain bracket. Dividend tax rates have fallen similarly. The personal exemption is expected to rise to \$3500 for 2008. Std deduction is expected to be \$10,950 MFJ and \$5450 SGL. The Educators tax deduction of \$250



Peyton, Rhonda, and Russ

revived for 2008. The tuition and fees deduction expired after 2007, but is expected to be revived. The IRA-to-Charity direct provision allowed taxpayers to contribute directly to charity from their IRA. without a reportable withdrawal, and the IRS is expected to address this expiration issue as well in 2008.

In 2009, the Federal Estate Tax Exemption increases to \$3.5 mil., and is scheduled for repeal in 2010...we'll see what happens there.

In 2010, Roth IRA conversions can be made by anyone, even those currently hampered by the \$100k AGI ceiling...so this year is special for those high income earners looking to convert their IRA's and never have to take a Required Minimum Distribution again.

In 2011, the Federal Estate Tax returns to a mere \$1mil exemption amount. Capital Gains rate returns to 20% and Dividends are again treated as ordinary income. The child tax credit falls back to \$500. Section 178 Expense Deduction for business owners falls back to \$25,000 from it's current \$125,000 level.

Let's all hope Congress deals effectively with the 2010 expirations!!

Portfolio Design: What's behind it all?

As fee-only advisors, we do things a little different than brokers when assembling and maintaining your portfolio. First, we use only mutual funds which are "No Load"...they neither charge you nor pay us for inclusion in your portfolio. Also, we are active managers of your account...we re-evaluate our initial allocation and fund choices, altering when needed to make sure your account contains our current best thinking...always.

There are 2 important elements to portfolio design: 1. the allocation and 2. the mutual funds selected.

Research shows that the asset allocation policy (how much stocks, bonds, and which kind of each are used) is the most important decision, and has the biggest impact, on investment success. It is for this reason that we consult various outside experts to help us design the portfolios. Litman-Gregory is our main source of wisdom on this matter. Their role is to ascertain for us, based on historical benchmarks, the optimum asset allocation for 4 places on the risk spectrum, ranging from low to high risk. This is referred to as the neutral portfolio stance, where diversification is thorough and deep, and where risk is minimized in all market

environments.

A second level of research is on-going, adding a tactical element to our portfolios. Because markets behave strangely at times, and overreact to the news of the day, there are occasionally what we call "fat pitch" opportunities, when the valuations within a certain asset class are so low relative to historical norms that they warrant special attention, and added allocation, within our strategies.

Once the asset allocation decision had been made for the quarter, mutual fund managers need to be selected. There are over 20,000 mutual funds out there, so this is no easy task. Once again we look to Litman-Gregory for help.

Past performance is no guarantee of future results...we've all heard this time and again, because it's true!! Shopping the list of good-performing mutual funds is only the beginning of our process. Numbers are important, but they don't tell the whole story, and they do NOT predict the future winners...in fact half of today's winners will fall below median in the next cycle. What can we do to improve our odds...to give us "an edge"?

We believe that well run, stable organizations are the most likely to replicate good results. And this applies to mutual fund organizations as well. That's why Litman-Gregory, on our behalf, visits every mutual fund company we use in your portfolio, and why future success, while not guaranteed, is at least probable when quality of organization is a big part of the selection process.

Some of the best, and ALL of the cheapest, mutual funds are "institutional"...they have large minimum purchases to deter all but the largest entities from using them. Also, some of the best funds are "closed to new investors", so they do not become unmanageably large.

Because our investors accounts are combined into one large (Omnibus) account, and then partitioned electronically, we are able to buy true institutional shares on a preferred basis. This means we enjoy pricing that is 20-30% cheaper than retail buyers.

Closed funds are available too.. Because the Omnibus account is already a client of the closed funds, even new clients can access these "closed" funds!

You get only the best here at Russell Hawkes Associates!!



Characteristics of Neutral Allocations

PORTFOLIO TYPE	RISK LEVEL		INVESTMENT ALLOCATION			
	1-Year Loss Threshold	Probability of Violating Loss	INV-GRADE BONDS	LARGE-CAP STOCKS	SMALL-CAP STOCKS	FOREIGN STOCKS
Conservative Balanced	-5%	2.2%	60%	30%	5%	5%
Balanced	-10%	1.4%	40%	40%	8%	12%
Equity-Tilted Balanced	-15%	0.9%	25%	50%	10%	15%
Equity	-20%	1.2%	0%	65%	15%	20%

Portfolio Allocations as of January 2008

INVESTMENT ALLOCATION

PORTFOLIO TYPE	In-vestm ent	Multi Sector Bonds	Emerg ing Mar-	Large Cap Growt	Large Cap Blend	Large Cap Value	Small Cap Stock	Intl Stocks	Global Funds	Commodity Futures
Conservative Balanced	34%	11%	10%	11%	12.5 %	12.5%	1%	5%	0%	3%
Balanced	19%	9%	6%	12.5%	22%	12.5%	1%	8%	7%	3%
Equity-Tilted	9%	5%	5%	16.5%	25%	16.5%	1%	10%	9%	3%
Equity	0%	0%	0%	21%	32%	20%	3%	14%	10%	0%



“Patience is required and rewarded, each more so as your portfolio is positioned in stocks.”

It is important to note that returns can vary significantly. For instance, from 1/1/70-12/31/07 the best and worst returns for a “balanced” neutral allocation portfolio for the following time periods were as follows:

Period	Best Return	Worst Return
1-Year	44.8% <i>(for the period ended 6/30/83)</i>	-23.6% <i>(for the period ended 9/30/74)</i>
3-Year	27.7% <i>(for the period ended 7/31/87)</i>	-6.3% <i>(for the period ended 3/31/03)</i>
5-Year	24.3% <i>(for the period ended 7/31/87)</i>	0.6% <i>(for the period ended 3/31/03)</i>
10-Year	16.4% <i>(for the period ended 8/31/87)</i>	6.5% <i>(for the period ended 7/31/07)</i>

Registered Investment Advisory



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The National Association of Personal Financial Advisors (<http://www.napfa.org>) is committed to the fee-only business model, to eliminating the conflicts of interest, and to offering an alternative to traditional financial sales.

Russell Hawkes Associates is a proud member of NAPFA.

Fee-Only Portfolios are designed to provide cost-effective asset management to investors of all stripes. Russell Hawkes Associates Inc is a fee-only advisor to the Portfolios. They use only no-load products, and are never driven by the incentives that commissions offer.

Huntington National Bank is, in conjunction with Fidelity, retained as the custodian/trustee to the Fee-Only Portfolios.

An Omnibus Account is in place to aggregate all accounts and buy institutional shares at a low cost to investors. On-Line Access is provided.

Using a system of quality control, the best mutual funds are selected for use in the Fee-Only Portfolios.. Litman-Gregory provides independent counsel to the Portfolios.

Portfolios can be assigned to each investor through a simple self-administered needs test, or a full financial plan prepared by the Advisor.

You can't ignore the **Fund-amentals**

Goodbye Harbor...we're sailing off to Brandywine

We are eliminating Harbor Capital Appreciation (HACAX) in favor of the Brandywine Blue mutual fund (BLUEX).

BLUEX is a large cap growth stock fund manager whose manager Freiss Associates of Delaware has been at the helm since 1991. They have averaged 12.2% for the past 5 years, 9% for 10 years, and 13.6% for the past 15 years.(as of 5/31/07source:Mornings tar)

BLUEX seeks out compa-

nies who are capable of beating the earnings estimates of Wall Street. It is their requirement before any company will make their radar screen.

How do they do this? Well, the largest distinguishing research characteristic of BLUEX is their system of tireless "trade checks". For instance, as a believer in Dicks Sporting Goods, they sought out Under Armour's opinion, how they felt about dealing with the buyer's at Dicks, and

whether Dick's new stores were capable of beating the earnings estimates. Good news from their trading partners meant it was a buy for them.

Only when BLUEX feels as though a company has the capability to beat earnings estimates is it included. This unique style ignores such things as sector weightings and growth vs. value, but has provided some excellent returns to investors due to their disciplined style.



PICKING MUTUAL FUNDS

Starting with quantitative analysis, we seek out funds with a minimum 5 year track record under current management. We then want superior returns at a low risk level.

Remaining funds are then subject to extensive questionnaires to complete, and on-site visits to confirm company and organizational quality.

Finally, we look for a competitive research or systemic edge which has a discernible advantage over it's peers.