ARISTA WEALTH ADVISORS

October 2011 | Vol No.1 | Investment Updates

Reacting to short term markets

Many of our clients that have been invested with Arista for a while know that we are strong proponents against reacting to the short term markets and that we focus on the long term horizon. A first and natural reaction to a market downturn is fear. However, through history we have learned that markets go up and markets go down. While there may be short term losses, the market tends to rebound and reward long term investing by moving even higher. No one can predict ahead of time when those negative stock market returns are going to occur. You have to be willing to say invested through a bear market (market losses of over 20% from peak to trough) or be prepared to lose money, because no one will be able to consistently time the market to get in and out and avoid down years. You may actually benefit from rebounding periods by staying fully invested. It is proven that market timing does not work and investing with emotion can cause your performance to suffer. Refer to the enclosed chart reflecting performance in the S&P 500 over a period of 20 years.

As demonstrated by these historical returns, did you know that the S&P 500 Stock Market has negative returns on average one out of every four years? We are enclosing a chart reflecting those averages. Understanding that the market has occasional corrections, it is important to keep in mind that it is possible to achieve long term positive returns!

Here is some simple advice to follow that may increase your market returns: 1) Do nothing, 2) Your money is like soap, the more you handle it, the less you have, 3) Never sell equities in a down market, 4) Science works – it's been academically proven that a disciplined approach to investing delivers higher market returns.

As always, we strongly encourage you to contact our office for a portfolio checkup and ensure you are invested appropriately in line with your risk tolerance, goals and objectives.

Tim Casserly
President

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Monthly Market Commentary

August saw market participants reacting wildly to any economic news, good or bad. As new worries in Europe, compounded by a European slowdown in second-quarter GDP growth, developed, investors were concerned that it would be more difficult for Europe to deal with its intractable debt crisis. On the other hand, factory orders, home prices, and consumer spending looked positive, and equity markets followed the news flow. Markets collapsed on the Friday before Labor Day long weekend because the overall economic news was bad, but not bad enough for Bernanke to reconsider another round of quantitative easing.

GDP: Second-quarter GDP was revised downward to 1.0% from 1.3%. The reduction was mainly because of changes in export data and inventory adjustments caused by slowing inventory growth. While a lower GDP growth number is never good news, consumption and business spending actually improved, setting us up for a better third quarter. Growth of 2.5%–3% is generally considered normal growth for the U.S. economy, indicating that we've so far had a lackluster recovery in the first half of 2011.

Employment: August reported no job growth, although the report was distorted by the 45,000 striking Verizon Communications employees who were considered unemployed. The government sector continued to contract, and that was offset by growth in the private sector—led by health-care and business services in August. Hourly wages and hours worked were down, partially because of falling inflation and summer vacations. Unemployment remained flat at 9.1%.

Housing: After a yearlong decline, housing industry prices began to turn upward in the second quarter and in June specifically. With fewer homes entering the foreclosure process, higher rents and a low interest-rate environment could combine with stabilizing home prices, and the construction market may see improvements as early as 2012 given small (165,000 units) new-home inventories and the 110 million or so existing households.

Manufacturing: The ISM Manufacturing Index fell in August, although to a lesser degree than expected, which indicated continued monthly expansion albeit at a very slow rate. One of the causes of concern was a drop in exports, which were a major driver of our economic recovery earlier on in the year. The anemic manufacturing industry also depressed manufacturing employment.

Consumers: Retail consumption continued at a healthy pace in August, led by luxury goods and wholesale clubs, despite Hurricane Irene. Despite Hurricane Irene, supply problems from Honda and Toyota, and weak consumer confidence, August auto sales remained remarkably resilient and stayed flat, though up almost 8% compared with last August. Inflation continued to decline with cheaper gasoline and cheaper cars, indicating stronger inflation-adjusted consumption numbers in the months ahead.

Domestic News: Fed chairman Ben Bernanke's speech at Jackson Hole, Wyo., where the annual global central banking conference was held, resulted in no immediate third round of quantitative easing but a reaffirmation that low policy rates will be maintained until mid 2013. It was also announced that the Federal Open Market Committee meeting in September will be extended from one to two days, indicating a more thorough discussion in evaluating if further measures will be necessary to help the U.S. economy. Market participants initially reacted negatively to the quantitative easing announcement but later took some solace with the announcement of the no-interest-rate-increase-until-mid 2013 pledge, allowing for a continued cheaper cost of borrowing in the next two years.

Tax Law Changes for 2011

A good mantra, for investing and for the rest of your life, is “Focus on what you can control.” While most people are inclined to put taxes into the "out of my control" bucket, that doesn't have to be the case. Where taxes are concerned, it is always a good idea to consult with a tax professional. This article is intended only as a starting point to help you become informed about tax-law changes; it does not constitute tax advice. Some of these changes have an impact only on those in very high tax brackets, while others affect individuals of all income levels.

Social Security Payroll Tax Holiday: Social Security payroll taxes have dropped from 6.2% to 4.2% for 2011, giving an effective boost in pay to all workers. (As in the past, you won't pay Social Security tax on any earnings over a certain level--currently $106,800.) This provision is designed to get people out there spending, but a better idea, assuming you can afford it, is to divert that money to another retirement fund: your own. Increase your 401(k) plan contribution as close as you can to the annual limit; in 2011, that limit remains $16,500 for those under 50 and $22,000 to those over 50. And if you're already funding your 401(k), 403(b), or 457 plan to the max—or if you would rather save outside the confines of your company plan—you can direct that money to an IRA instead. IRA contribution limits are also unchanged from 2010: $5,000 for individuals under 50 and $6,000 for those over 50.

Alternative Minimum Tax: Toward the end of 2010, Congress put in place a so-called patch to keep a new group of taxpayers from having to pay the alternative minimum tax, a parallel tax system that disallows many of the credits and deductions that taxpayers are entitled to under the conventional tax system. That's good news, but if you've fallen into the AMT zone in the past, the latest patch isn't likely to keep you out of it. However, by taking steps to control your AMT-subject income and managing your deductions, you may be able to reduce your AMT tax hit. Some key strategies that you can employ include carefully managing the exercise of stock options (a well-versed tax advisor should be able to help with this) and watching out for private-activity municipal bond funds, which aren't taxable under the conventional tax system but are for the purposes of AMT.

Dividend Tax: Through 2012, the tax on qualified dividends remains at zero for taxpayers in the 10% and 15% tax brackets, and is 15% for all other taxpayers.

Long-Term Capital Gains Tax: Through 2012, taxpayers in the 10% and 15% brackets will not owe capital gains tax on the sale of assets they've owned for more than one year. Long-term capital gains tax rates remain at 15% for all other taxpayers. Short-term capital gains are taxed as ordinary income.

Estate Tax: Although the federal estate tax was set to jump to 55% for estates of more than $1 million in 2011, last-minute Congressional maneuvering resulted in a much less onerous rate for people who die with a lot of assets. The top estate tax rate is 35% for 2011 and 2012, and it only affects those who have amassed estates of more than $5 million. Those who inherit assets will also once again receive a step-up in the cost basis of those assets, meaning that the inherited assets are valued at their fair market value as of the decedent's death.

Given the more generous estate-tax limits, you may be assuming that a visit to your estate-planning attorney isn't necessary, but even if you don't anticipate that you will ever amass $5 million in assets, there's more to creating an estate plan than sidestepping taxes. A properly crafted estate plan will detail how you would like your assets distributed after you are gone. Gift Tax: The annual gift-tax exclusion stays the same as it was in 2010: $13,000. That means you can gift $13,000 apiece to an unlimited number of people this year without having to worry about a gift tax or even fill out the gift-tax paperwork.

Dangers of Market Timing

Two of the most dangerous words in the investing world are “market timing.” Market timing occurs when investors try to predict which direction the stock market will head. While some investors have been known to make money timing the market, it is highly inadvisable for long-term investors to try this extremely risky strategy.   Opponents of Market Timing: Most investors and academics believe it is impossible to forecast market movements. Such a technique amounts to gambling when compared with a sound investment approach. It fails far more than it works, and market timers often end up buying high and selling low. Furthermore, you run the risk of missing periods of exceptional returns. For example, over the past 20 years, a $1 investment in stocks, as represented by the Standard & Poor’s 500®, would have grown to $5.75. If that same $1 investment happened to miss the best 13 months of stock returns over the past 20 years, the ending value would have equaled only $1.96. This would have been less than the value for an investor in a 30-day Treasury bill, a.k.a. cash, $1.97. Only those who remained invested in stocks throughout the entire period were sure to get market exposure during the crucial hot months.

Advocates of Market Timing: On the contrary, a number of websites, newsletters, and other trading services boast they can time the market. While their returns may have in fact beaten the market by a considerable margin, it’s safe to assume that these systems can’t consistently hold up over the long term. On some occasions and during some stretches of time, market timing can help generate impressive profits. However, you must be familiar with the dangers behind such an approach.

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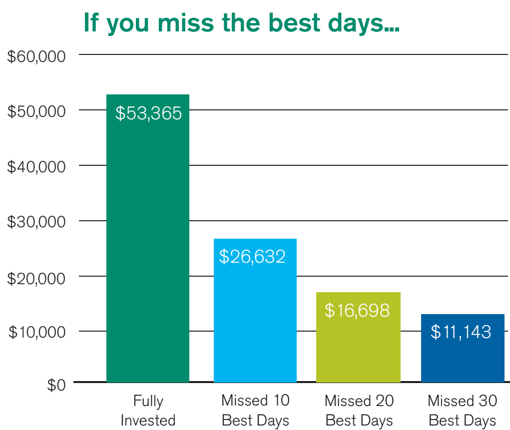
Buy Right and Sit Tight

Market Timing Doesn't Work

No one knows when market gains will occur and missing just a few of the market's best days can lower your return substantially. To take advantage of market gains, stay fully invested and don't try to time market moves. However, even staying fully invested cannot ensure a profit.

Stay Fully Invested and Don't Try to Time the Market

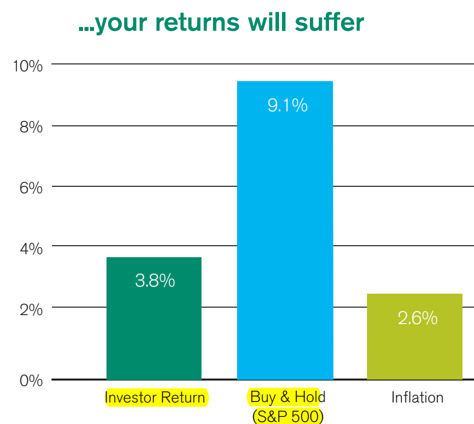
If you miss the best days...



Growth of $10,000 in the S&P 500, 20 Years Ending June 30, 2011

Sources: Standard & Poor's; American Century Investments

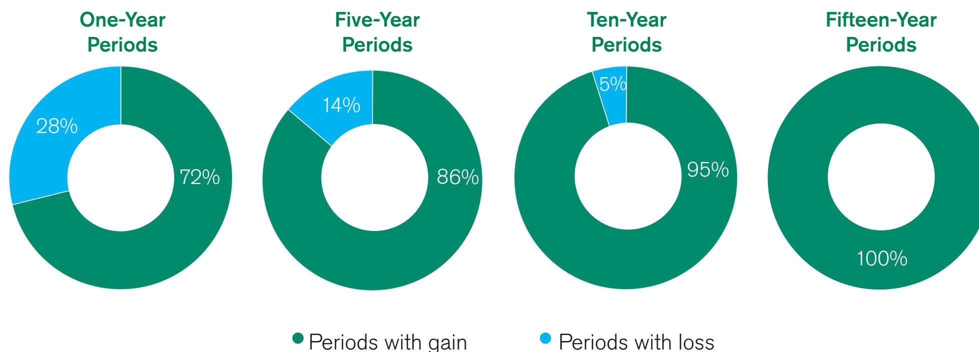
...your returns will suffer



Equity Investors' Performance, Annualized Returns, 1991- 2010

Source: DALBAR Quantitative Analysis of Investor Behavior 2011

Probability of Past Holding Periods Generating Positive Returns



The percentage of negative versus positive annualized returns for large company stocks, as represented by the S&P 500 Index, over one, five, 10 and 15 calendar year holding periods (1926-2010).

Sources: Standard & Poor's; American Century Investments. The chart shows holdings of 85 one-year periods, 81 five-year periods, 76 ten-year periods and 71 fifteen-year periods. The data assumes reinvestment of all income and does not account for taxes or transaction costs. Stocks are not guaranteed and are more volatile than other asset classes. Stocks provide ownership in corporations that intend to provide growth and/or current income. Capital gains and dividends received may be taxed in the year received. An investment cannot be made directly in an index.

The S&P 500 Index is a capitalization-weighted index of 500 widely traded stocks. Created by Standard & Poor's, it is considered to represent the performance of the stock market in general. It is not an investment product available for purchase.

This information is for illustrative purposes only and is not intended to represent any particular investment. Past performance is no guarantee of future results.

Historical S&P 500 Index Stock Market Returns	
Year	**Return**
1973	-14.70%
1974	-26.50%
1975	37.20%
1976	23.80%
1977	-7.20%
1978	6.60%
1979	18.40%
1980	32.40%
1981	-4.90%
1982	21.40%
1983	22.5
1984	6.30%
1985	32.20%
1986	18.50%
1987	5.20%
1988	16.80%
1989	31.50%
1990	-3.20%
1991	30.50%
1992	7.70%
1993	10.00%
1994	1.30%
1995	37.40%
1996	23.10%
1997	33.40%
1998	28.60%
1999	21.00%
2000	-9.10%
2001	-11.90%
2002	-22.10%
2003	28.70%
2004	10.90%
2005	4.90%
2006	15.90%
2007	5.50%
2008	-37.00%
2009	26.50%
2010	15.10%