On the Horizon

Spring 2010

Horizon Notes

Annual Report—Despite the recession and the ups and downs of the market in the past year, Horizon Advisors continues to attract new clients. We serve a growing number of clients and their families, helping to simplify their complicated financial issues by providing planning, investment management, accounting and administrative services.

As of the end of 2009, we serve 88 households with approximately $150 Million in managed assets, including $100 Million in discretionary assets and $50 Million in non-discretionary assets.

As we begin this new decade, we thank you for your ongoing support and confidence in our services and for referring your friends and family to our firm. If you know someone who can benefit from a relationship with Horizon, we're happy to offer a free, confidential consultation to discuss our services.

We have recently completed work on a brief, simple summary of our firm which describes our services and our philosophy. The summary is available on our website if you'd like to take a look or share it with others. You can access the summary at www.horizon-advisors.com. Click on the link which says "View One-Page Summary."

Investing is an Act of Faith

One of our clients recently commented that "nothing seems safe anymore" and another mentioned that he is "disgusted with the games Wall Street plays." Following these and other similar comments, we turn to Vanguard founder, Jack Bogle, who wrote that "Investing is an act of faith."

Perhaps the most damaging result of the recent financial dislocation is that investor faith has been shaken, resulting in the financial services business as a whole losing the trust of the investor community. This trust, which was hard earned over many years, was gradually replaced by self interest - in creating more wealth for the industry and at the same time transferring more risk to investors. Financial engineering triumphed over common sense, and an alphabet soup of financial products spawned the credit crisis of 2008.

The best summation of the attitude that many on Wall Street seem to have adopted is captured in the words spoken in July 2007, by the then-CEO of Citigroup, Charles Prince, "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing."

We have heard a lot of excuses as to who's to blame for the mess; however, the fact remains that many on Wall Street ignored the franchise of trust which investors had bestowed on them. Whether Wall Street believed it or not, the public expected more of them. The financial services industry which has long relied on the implicit trust of the investing public placed their own interests ahead of their clients and even the shareholders of their companies. Now, the public has been reminded that a man cannot serve two masters and has become skeptical of the motives of these companies.

The chasm between Wall Street and the investing public is wider than ever; a direct result of Wall Street's desire to dance, rather than protecting their franchise of investor trust. We predict that it will be a long time for the bridge between Wall Street's self interest and the trust of their investors can be repaired.

So, you might reasonably ask, what makes Horizon Advisors different? Why should anyone trust us more than others in the business?

When we created Horizon Advisors, in early 1999, we sent a card to our friends announcing our new business and objectives, which read in part:

"Our shared mission is to develop long-term relationships with thoughtful and successful individuals, families and organizations so that we can assist and support them in achieving their goals."

While many things have changed since 1999, one thing has not; we, at Horizon, have not forgotten our mission. We have continued our single-minded focus of serving our clients who have entrusted their financial futures to us. We have maintained our disciplined approach, preferring solutions that are understandable and have stood the test of time. We embrace a fiduciary standard, putting the interests of our clients ahead of our own, with a dedication to client service and responsiveness. These are values upon which we have built the trust we share with our clients and we think this makes us different.

Market Review—A Retrospective Look

The following table shows market index returns for 2009 through Dec. 31st, trailing 3-mos., 12-mos., and 3 years.

Index (Through 12/31/09)	4th Qtr	1-Year	3-Year
S&P 500 TR (Large Stocks)	6.04%	26.46%	-5.63%
EAFE TR (Int'l Stocks)	2.18%	31.78%	-6.04%
Barclay's Bond Aggregate	0.20%	5.93%	6.04%

After two years of gut wrenching turbulence, the economy now appears to be on the mend. By most accounts, the recession ended sometime in the middle of last year. The economic growth which began in the second half of 2009 is expected to accelerate in the coming year as business activity continues to improve and confidence grows. Better than expected earnings reports in recent quarters were at first led by cost cutting efforts, but recently have been reinforced by sales or "top line" growth. This sets the stage for significant earnings growth in the coming quarters.

More importantly, employment has stabilized and many expect the resumption of job growth in the coming year. Although, unemployment may remain relatively high for a while longer as businesses remain cautious about adding expenses. Note that unemployment ordinarily does not peak until well after a recession has ended.

Despite the recent pullback to start 2010, we think the stock market will continue to rise. We believe that the market was oversold at the March lows and remains undervalued today, even after last year's solid increase. We believe that GDP output and corporate earnings will return to peak levels in the next few years which will make the market at current levels appear very attractively priced. However, the tone of the market is beginning to change. The steep snapback from the oversold March levels has likely ended. The pace of the rise was primarily a result of the market regaining the ground that was lost in a panic. We now expect a transition to a more normalized return pattern that will remain tilted upwards.

Most of our near-term market related concerns are focused in the fixed income market. We believe that given the relative fragility of the financial system and credit markets, that interest rates are far too low. In many cases, interest rates are lower now than they were before the credit crisis began. There are two principal reasons for these low interest rates. First, the Federal Reserve has been actively depressing interest rates by setting the Fed Funds rate to (near) zero and by purchasing US Treasury and Government Agency securities. Second, investors poured money into fixed income investments throughout 2009. We have responded to these concerns by reducing interest rate risk and credit risk in our clients' portfolios.

We also expect that the massive amounts of stimulus provided by the government will eventually lead to higher than normal inflation. High unemployment and low capacity utilization rates will temporarily dampen inflationary pressures, but we believe that once the economic recovery is in full bloom, inflation will become an increasing concern. We have responded to these expectations by adding inflation protected bonds and a natural resources oriented fund to many of our clients' portfolios.

Having suffered through the world's first global recession, it has become clear that the key driver of global growth is in emerging economies, such as China, India, and Brazil. While most developed economies suffered severe declines in output, the impact of the recession on many emerging economies resulted in merely slowing from a double digit growth rate to a still impressive high single digit growth rate. The pace of economic development in these countries is stunning and appears likely to continue for some time. To capture this expected growth in our clients' portfolios, we have enhanced the international allocation in our clients' portfolios by adding a fund that invests specifically in emerging markets.

In summary, we are cautiously optimistic about the market and the economy in the coming year. There is a lot of evidence that most of the negative trends that battered the markets in 2007 and 2008 are now improving. We think that economic recovery is well underway and will soon accelerate. With these improvements, the stock market should continue to rise. Our key concerns, for now, are in the bond market as interest rates appear unsustainably low and the specter of inflation continues to loom.

Thank you very much for your continued confidence in our service and advice. If you would like to discuss our opinions, outlook, or your portfolio in greater detail, we would be happy to schedule a meeting or a conference call at your convenience.

The Search for Simplicity

"The great enemy of the truth is very often not the lie -- deliberate, contrived and dishonest, but the myth, persistent, persuasive, and unrealistic. Belief in myths allows the comfort of opinion without the discomfort of thought." - John F. Kennedy

One of the great myths in investing is that someone, somewhere has the key to predicting the future. The news, especially at times like this, is full of experts who will make all sorts of predictions about what is going to happen in the coming year or years. Many of these predictions will be well supported and persuasive and, if history is any guide, most of these predictions will be wildly inaccurate.

In the short run, however, many of these predictions can be very compelling, giving investors the "comfort of opinion" to take action based on the predicted outcome. While people may understand, intellectually, that the future is unknowable, we still find comfort in basing our decisions on forecasts and predictions. This, then, is the danger in the myth that the future is predictable—that we act based on these dubious expectations.

Forecasts and predictions do not make for good long-term advice. Nothing will be as good or as bad as predicted and we really have no way of anticipating the unexpected events which will certainly occur. Even where 20-20 hindsight allows us to deconstruct what happened, we don't gain any predictive value from this, just an understanding of how the (then) unknowns came together to create the past.

So, given the uncertainty of the future, how is an investor to proceed? We thought it would be helpful to review a few simple rules for investing that are the foundation for our process.

Rule #1 - Understand your time horizon: Every investment plan should begin with a definable "time horizon" for goals and objectives. These time horizons can vary greatly depending on individual goals and circumstances. For example, a 40 year old couple who are saving for the education of their children will have a much shorter time horizon than a similar couple who are primarily concerned with funding their retirement. These are clearly different goals, and portfolios should be designed to provide for each of them.

Rule #2 - Know your risk tolerance: What we define in technical terms as risk tolerance is probably better described in the behavioral sense as your "Sleeping Point." Your sleeping point is achieved when your can comfortably sleep at night without worrying about your portfolio, regardless of the market environment. Fundamentally, investment rewards can only be achieved at the cost of risk-taking. Every investor must decide the trade-off he or she is willing to make between eating well and sleeping well. So what is your sleeping point? Finding the answer to this question is one of the most important investment steps you must take, but it can be an extremely difficult determination. Many investors discovered in the recent downturn that they had misjudged their sleeping point.

Rule #3 - Remain diversified: As we discuss above, the future is unknowable, so with an eye to meeting your personal goals, it serves most investors to stay invested in a wide variety of both stocks and bonds with very little concentration in any one investment. Diversification helps to minimize the impact of unexpected circumstances that might severely impact a particular investment. It also increases the odds of investing in things that are doing very well.

Rule #4 - Stick to your plan: Davy Crockett once advised to "Be sure you're right, then go ahead." Once you have carefully considered the steps above, it is essential that you commit to a long-term strategy and stay the course, especially when faced with extremely good or bad periods of performance. Historically, lurching back and forth in the markets influenced by greed or fear has been a sure path to dismal returns. Rather than buy low and sell high, many feel compelled to do just the opposite. It's been said that investors lose their heads in good markets and lose their nerve in bad ones.

Following these rules, investing is simple, but it's not easy. Fortunately for our clients, we are here to help them make informed decisions. We help them define their time horizons and risk tolerances. We use our disciplined due diligence process to properly diversify their portfolios. Finally, and most importantly, we help our clients stay the course through good times and bad.

Tax Updates

We know what the tax laws are at this moment but we're uncertain about what the future holds.

As to income taxes, if we had to guess, we think that tax rates will remain unchanged through 2010, when the "Bush Tax Cuts" expire and rates return to higher levels. It will be much easier for Congress and the Administration to avoid addressing this issue and just let time take its course, so that taxes will increase without taking any action. But, bottom line, we think it's likely that tax rates for our clients will increase in either of the next two years, so depending on your particular circumstances and ability to "shift" income or expenses from one year to the next, some thought should be given to whether 2010's rates may be "as good as it gets" for some time.

As to estate taxes, the estate planning community had predicted for years that the elimination of the estate and gift tax, which was scheduled to take effect on January 1st of 2010 would not occur. Surprising everyone, as we described in our email in late December, Congress failed to extend the 2009 provisions, and at this writing there is no estate tax for the balance of 2010. Most professionals continue to be of the opinion that Congress will restore the exemptions and rates that were in effect last year, but stay tuned and we will keep you informed. There could certainly be more surprises on the horizon.

The annual gift tax exclusion or tax free gift amount remains $13,000 per person for each donor. In addition, tax free gifts can be made for direct tuition or medical expense payment to providers on behalf of children or grandchildren.

We will keep you posted on important developments as they occur, but we will be happy to meet with any of our clients and friend to discuss how these changes may affect your personal circumstances.

COLLECTED THOUGHTS

"Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria."
- Sir John Templeton

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