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Points of interest:

- Chippy investment markets are normal: the S&P 500 Index fell during 23 calendar years from 1926 through 2006.
- There were 371 down months for the S&P 500 from Jan. 1926 through Nov. 2007.
- Despite declining more than a third of the time, the S&P 500 Index's annualized return was over 10% from 1926 to the present.

THE STOCK MARKET OFTEN MOVES TWO STEPS FORWARD, ONE STEP BACK

One of the hardest things to accept about the stock market is its volatility: prices rise and fall day to day, month to month, and year to year. One month an investor's account has grown to a certain level, and the next month it has fallen back a few percent from that high, making the investor feel like he has "lost" money.

Someone who is used to the steady, slow growth of a savings account may find this alarming. They may feel good when their portfolio hits a new high point, only to feel tricked when it inevitably drops back from that peak a few days or weeks later.

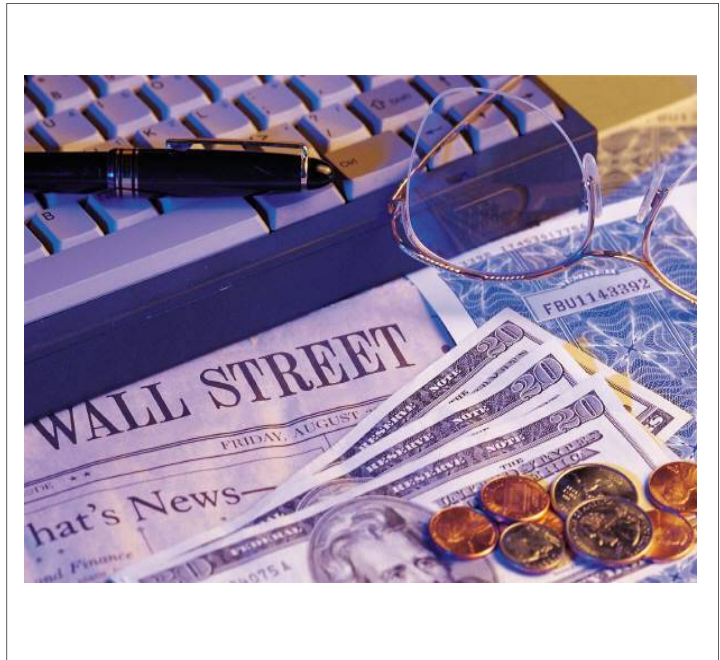
Investors new to the market since 2003 may have found the big swings of 2007 especially disquieting, given that the three previous years featured remarkably low downward volatility and a fairly steady upward increase.

The name of the game

The truth is that chippy markets are normal: investors who want the potentially higher long-term gains that come with stock investing have to be willing to accept short-term declines.

The annualized return on the U.S. stock market—as measured by the Standard & Poor's 500 Stocks Index—was about 10.4% from Jan. 1926 through Nov. 2007, according to Standard & Poor's.

However, that does not mean stocks went up 10.4%



An investor who watches his portfolio weekly or monthly can get upset when he sees a decline in value from a recent high.

year after year. In 1931, for instance, the market fell by almost 43%. In 1933, it gained 54%.

The market fell during 23 calendar years in the period from 1926 through 2006. Despite that, the overall long term gain was over 10% a year.

Investors who get upset when their portfolios fall during a particular month are setting themselves up for disappointment more than a third of the time, on average.

From Jan. 1926 through Nov. 2007 the S&P 500 Index fell almost 38% of the time, heading down during 371 of

983 months. Those declines included a 4.2% decline in November 2007.

The index fell during four of the first 11 months of 2007, compared to 2006, when it fell during just one calendar month.

A little history helps

How can an investor stay focused while being pummeled by month-to-month declines in his portfolio?

Looking back at the recent past may help. For instance, imagine a portfolio that was worth \$95,000 at the beginning of the year and had grown to \$102,000 in

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DON'T FALL IN LOVE WITH YOUR PORTFOLIO'S HIGHEST RECENT VALUE

(Continued from page 1)

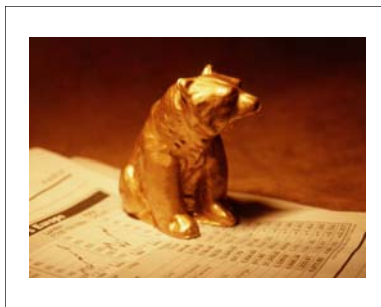
August. The investor would have been pretty happy in August, having enjoyed a return of over 7% in just eight months. Now suppose that the portfolio went up again in September to \$105,000, but got knocked back in October to \$102,000.

Should the investor feel bad because she "lost" \$3,000 in October and now has "only" \$102,000 in her portfolio? Looking back a few months might make such a feeling appear silly. After all,

this investor was quite happy to have \$102,000 in August. Why is she upset to have that same amount of money just two months later?

The only investor who should be unhappy is the one who had counted on using \$105,000 for a current purchase. In that case, the investor shouldn't have trusted his money to the market, knowing that short-term volatility can be high.

Long-term investors who don't need to spend all their



Stocks fall at least one-third of the time.

money today can afford to wait for future highs to boost their portfolios once again.

USE APPROPRIATE INDEXES FOR COMPARISONS

Investors who have diversified portfolios can find it difficult to compare their performance to that of "the market."

That's because no one index adequately reflects a portfolio that is invested in domestic and international stocks and bonds.

The most common reference point for unsophisticated investors is the Dow Jones Industrial Average, probably because it is long-established and widely followed by the financial press.

The Dow, however, reflects the performance of only 30 big U.S. stocks, a small fraction of the tens of thousands of domestic and foreign stocks and bonds that make up the world's investment markets.

That makes it possible for the Dow to go through periods when it does better—or worse—than the great mass of investable stocks, because the performances of a handful of its components can influence its movement.

Another widely-followed index, the NASDAQ, mainly reflects the performance of large stocks in technology businesses. It, too, can differ radically from the broader stock market.

A more appropriate—but still not perfect—gauge of the U.S. stock market is the Standard & Poor's 500 Stocks Index.

As its name implies, it represents the fortunes of the 500 largest publicly traded stocks in the United States.

Although it leaves out thousands of smaller stocks, the stocks it covers account for close to 90% of U.S. stock market value.

But the S&P 500 is only reasonable when compared

to a portfolio comprised primarily of large U.S. stocks.

If you own smaller stocks, then the S&P 500 may not tell you how they are doing, because they can move very differently from large stocks.

Meanwhile, including foreign stocks in a portfolio complicates comparisons further. Although foreign markets often move in tandem with the U.S. market in the short term, they can differ strongly over longer periods. Consider the year 2007, when U.S. stocks barely rose at all but

stocks issued in emerging foreign economies posted double digit gains.

Finally, a portfolio that includes bonds is likely to look better than a stock market index in bad times and not as good when the stock market is rising.

"But the S&P 500 is only reasonable when compared to a portfolio comprised primarily of large U.S. stocks."



You have to pick the appropriate mix of indexes if you want a true comparison of the performance of a diversified portfolio to the market.

HOW MUCH SHOULD AN INVESTOR WORRY ABOUT ANOTHER RECESSION?

The drumbeat of negative economic predictions continues as more forecasters predict that a recession began late in 2007 or will arrive early in 2008.

The latest convert is former Federal Reserve Chairman Alan Greenspan, who recently put the odds of a recession at 50% or better.

The U.S. economy has been expanding since the last recession ended in 2001 and signs that the economy have slowed are evident in corporate profits and the housing market.

How bad can it get?

Recessions have a nasty habit of taking stock market profits away, at least temporarily.

The U.S. stock market, as measured by the Standard & Poor's 500 Index, has fallen an average of 26% during the 11 recessions since 1945.

How concerned should an investor be? At least recessions are short-term events usually over in a year or less.

The average recession

since 1945 has lasted only 10 months, vs. the average 57 months of economic expansion, says the National Bureau of Economic Research, the group charged with declaring the beginnings and ends of recessions.

The longest since World War II were the 16-month declines in 1973-75 and 1981-82.

The most recent recession, in 2001, lasted just eight months.

Reasons for calm

An investor who has a balanced portfolio that includes stocks, bonds, and cash and who has a time frame of more than two years shouldn't be too concerned.

Although stocks often (but not always) fall during a recession, bonds usually perform well, keeping a balanced portfolio from falling as far as the stock market.

Sometimes cash investments generate high returns, as in 1973-75, and also shel-



Recessions can cause sizable temporary declines in portfolio values.

ter the portfolio.

Anyone investing new money should welcome the temporary declines that come with a recession, because they get to buy more shares at cheaper prices.

The stock market recoveries that develop at the end of recessions can quickly erase the previous declines.

For instance, the S&P 500 rose by 37% in 1975 and by 30% in 1991 after recessions drove the markets down.

“Anyone investing new money should welcome the temporary declines that come with a recession, because they get to buy more shares at cheaper prices.”

COLLEGE SAVINGS, BROKER FUNDS, & MORE

A lot of parents are apparently in the dark when it comes to preparing for the costs of a college education, a new survey by Fidelity Investments found.

The survey of 2,200 families with children under age 18 found that half started saving only after the child was four years old, thereby losing several years of compounded returns.

Only about 26% used a state-sponsored 529 plan for college savings, despite the tax advantages offered by the plans, the survey found.

About 21% had never even heard of the plans.

Broker funds lose out

The timing of investments by investors who purchase mutual funds through stockbrokers lags behind a simple buy-and-hold strategy, found a study by three college finance professors.

Investors who used brokers to buy funds with deferred sales charges known as B shares had particularly poor timing, lagging behind a buy-and-hold strategy in the same funds by almost 2.3%

annually, the study found.

Pensions fade away

Traditional defined benefit pensions are becoming scarce, said a survey by the Employee Benefit Research Institute.

It said employers are finding it more expensive to comply with new federal rules on the plans. A growing number of employers are freezing the plans and prohibiting new hires from joining them. Typically employers are expanding their 401 plans instead, it said.

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THE EXPANDED KIDDIE TAX LEAVES FEW ALTERNATIVES FOR SAVING

Remember the days when kids were encouraged to plunk away money for the future, especially for a college education?

It seems the federal government has lost the urge to encourage thrift. Starting this year, an expansion of the notorious "kiddie tax" discourages children from having large savings or investment accounts in their own names.

The kiddie tax began in 1986 in order to catch high income parents who were shifting large amounts of money or investments to their children in order to take advantage of the children's lower income tax rates.

Starting that year children under age 14 who had more than a modest amount of interest or investment income had to pay income tax



The federal kiddie tax is taking a bite out of some children's savings accounts.

at either their own tax rates or at their parent's tax rates, whichever was higher.

But two years ago Congress expanded the tax to children under age 18. Now it has expanded it to a maximum of age 24, if a child is a full-time student and not providing more than one-half of his or her own support.

The limit for a child's unearned income was \$1,700

in 2007: an inflation-adjusted increase for this year has not yet been announced.

So a child better not have more than \$34,000 in accounts earning 5%, for example, because the interest over \$1,700 may be taxed at the parent's rate.

Where does this leave families who want to save big money for college?

It is still OK to put some money in a child's name, but the bulk of the savings should be done in a 529 college savings plan account for those who want the maximum tax advantage.

These accounts defer taxes on earnings and allow them to be used tax-free if withdrawn for college expenses. Plus, they give a parent control over the account after age 21, unlike a traditional child's savings account.

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