



This Spring issue focuses on big picture economic and tax issues. The good news is that 2009 was a great year for low taxes. The not-so-good news is that taxes will likely never be this low again. And absent a miracle, there's only one way we're going to pay for our ballooning deficit—with a value-added tax (turn the page to learn more).

Market Valuations and Summary Investment Update

Investment decisions involve determining if one is being adequately compensated for risk. Currently the financial markets are overpriced based on a variety of valuation methods. The normalized price earnings ratio is now 21.3 which is on the high side based upon historical data. Our financial research network and professional investment colleagues concur with our valuation viewpoint. Given economic data including persistently high unemployment, a market pull-back would not be surprising. For more information on financial market valuations please refer to the Summer 2009 *HAS* Newsletter at haswealth.com.

The twin pillars of employment and housing remain wobbly and may take years to stabilize. In life and with investments, patience is our ally for long-term success. We continue to emphasize moderate, reduced risk and relative value investments which we expect to perform well in the current economic environment.

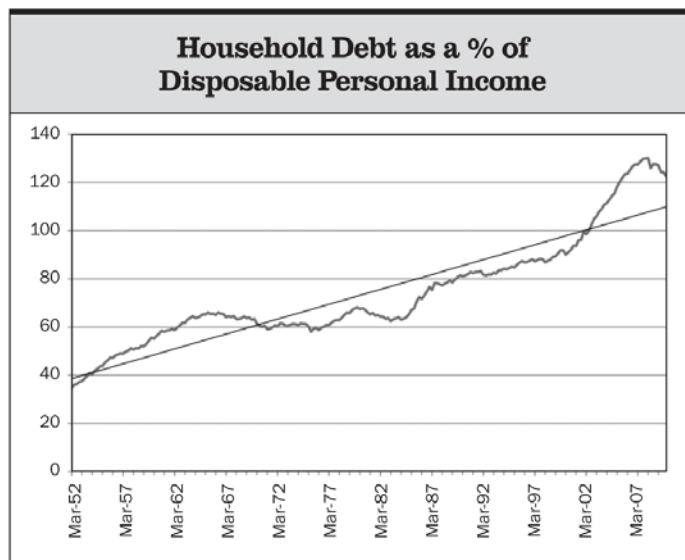
Though risk assets are not presently priced attractively, we anticipate there will be opportunities in the months and years ahead to increase positions in equity holdings, especially in the faster growing economies. In addition, most of our fund managers make proactive risk-reward adjustments based upon market conditions. These funds include PIMCO All Asset, Hussman, Matthews Asian, Oakmark Equity Income and Cohen & Steers Opportunity among others.

Just today, Craig Hillegas spoke with Doug Bond who manages the Cohen & Steers Opportunity Fund. This is our largest flexible dividend income investment. During our holding period it has surpassed expectations, achieving it's objectives of both capital appreciation and high current income, earning over 65% during the last 12 months with a current distribution yield of 7.5%. We'll report insights from today's hour-long chat with Doug Bond along with other managers in forthcoming eUpdates.

Tax Savings and Investment Tips

At *HAS*, we employ these and other strategies that have collectively save our clients millions in tax dollars. Applying these strategies in a coordinated manner helps further magnify their effectiveness.

- Employ tax-efficient investments that favor deferral and qualified dividend income taxed at lower preferential rates.
- Emphasize asset location with less tax-efficient skewed toward tax deferred accounts.
- Monitor funds for taxable distributions, possibly selling in advance.
- Tax swaps: sell investments that will directly offset current or future gains and reduce taxable ordinary income. Invest proceeds into a comparable investment.
- Accelerate income into lower tax bracket years (like 2010).
- Maximize deductions in higher bracket years.
- Employ retirement accounts and plans to benefit from both current tax deductions and tax deferral.
- Consider alternative investments that provide tax-advantaged income and/or tax deductions much like retirement plans.
- Evaluate merits of Roth Conversion – pay tax once and then benefit from potentially decades of tax-free growth.



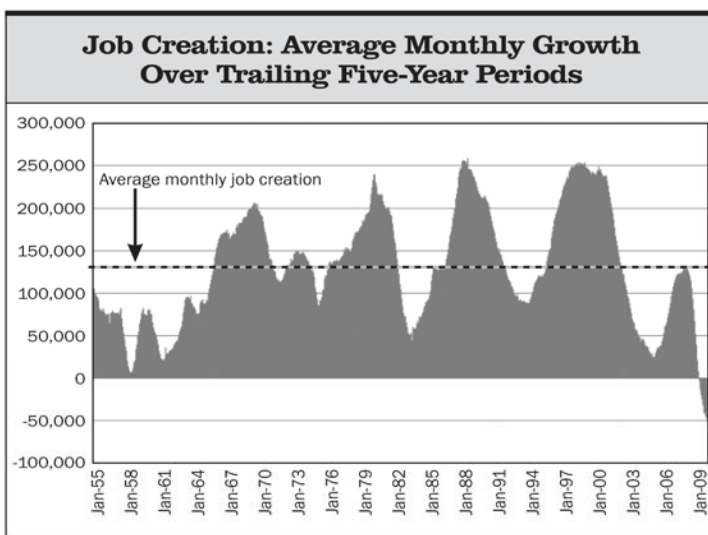
Debt is coming down, but is historically very high relative to income.
Source: Federal Reserve.

Looking Down From 30,000 Feet, the Landscape is Dominated by Mountains of Debt

A year ago the stock market had just started its rebound from the depths of the worst bear market in over 70 years. The powerful rally in “risk” assets over the past year is comforting. While we take some satisfaction in the returns we’ve achieved for our clients during both this short year and the long-term, we remain concerned, and our assessment of the key macro issues and risks that the global economy must deal with in coming months and years has not changed. Though the worst case of a great depression has been avoided, the global economy continues to struggle in the aftermath of massive wealth destruction and a hard stop to the decades-long trend of expanding indebtedness.

More so than in past periods, the investment climate in the years ahead will be highly influenced by how the key macro components of this environment unfold. We’ve seen massive growth in debt throughout society, reaching binge levels in the last decade. Think of all that debt as a form of borrowing against future consumption – now we must pay it back in the form of less spending. This suggests a sluggish economy, possibly for many years to come.

Government spending has kept the economy from falling off a cliff, but at a longer-term cost of massive deficits that will be difficult to fix without causing more damage – including the possibility that shifting gears to cut budget deficits too early could throw the economy into a significant and ugly decline.



According to Ned Davis, if job growth averages 150,000 a month over 10 years, unemployment won’t fall below 6% until 2019, or below 7% until 2018. It would break below 10% in 2013. Average monthly job growth since 1950 has been 120,000. The last 20 years, excluding the impact of the recession, job growth has averaged 137,000 per month. Source: Bureau of Labor Statistics.

There is still a lot of government spending that will roll out this year but unless there is a new round of stimulus, which is quite possible, it will dissipate in coming quarters. Inventories will be a positive growth driver for a while as they are gradually rebuilt, but this too will pass as the year progresses. Other sectors of the economy are strengthening—manufacturing in particular has been impressive but it is still far below its prior peak and overall, the economy is on fragile footing. What we don’t yet know is whether the economy will be on solid enough footing to stand on its own as government supports are withdrawn and inventories stabilize, or whether it will stumble and possibly contract again.

In normal cycles the consumer is the key to sustained growth. The weakness in this critically important sector suggests to us that a sluggish recovery is the most likely outcome over the next couple of years and that there is still risk of a return to recession if government policies are not skillfully managed.

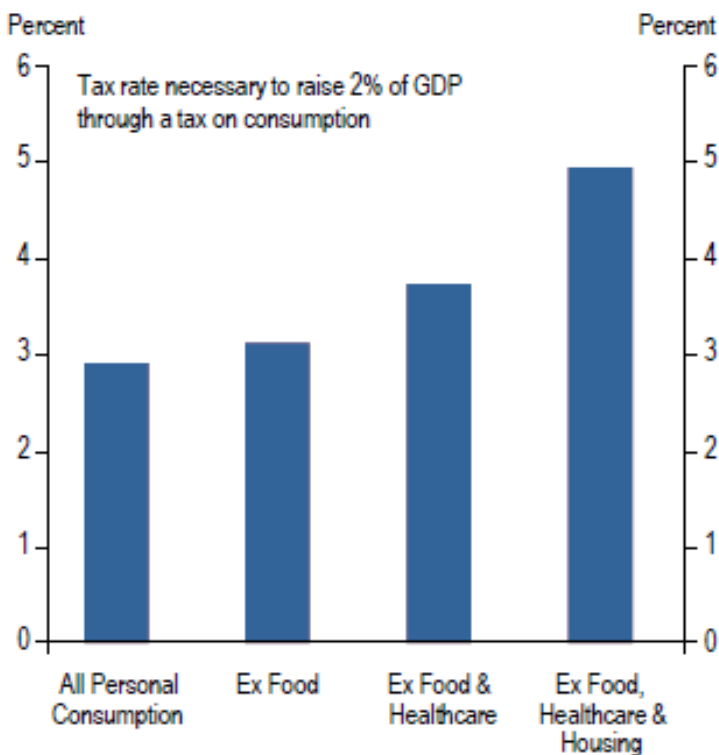
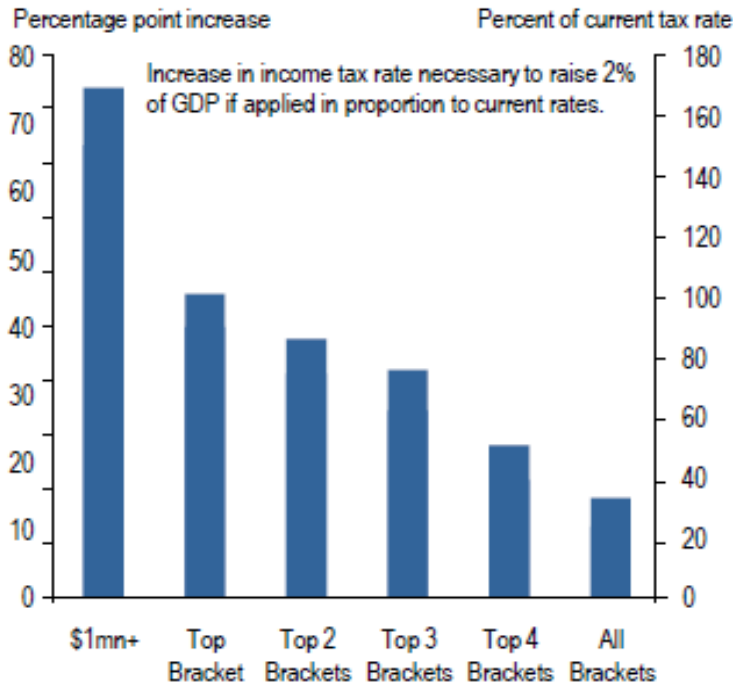
There are several important variables to a strong and sustainable economic rebound, but jobs are the most important. The big question is not whether the job picture will improve, but how much it will improve and how quickly. There is broad consensus elevated unemployment will persist for a few years. This requires higher government spending on unemployment and other social-welfare benefits. With slower economic growth, workers will be absorbed more gradually into the economy.

How Much is the Government Spending?

In 2009 the government had receipts of \$2.1 trillion and they spent \$3.5 trillion. This translates into \$1.67 of spending for every \$1.00 of revenue. Contrast this with the 2008 record-breaking deficit of just \$456 billion. Now the Federal Government forecasts a 2010 budget deficit of \$1.55 Trillion or 10.6% of GDP and another \$1.26 Trillion for 2011. (In brief, GDP or Gross Domestic Product is the total measure of economic activity, including all production, goods, services). This high level of spending can’t go on forever unless we want to follow in Greece’s footsteps. For kicks and context, jump to page 4 read the short excerpt on how big is a \$1,000,000,000,000 (Trillion)?

What’s VAT? Bigger Government, Higher Taxes

It’s no longer just our children and grandchildren that will be impacted by the myriad implications of massive deficits. We will experience the impact in the form of higher mortgage interest rates, higher taxes, slower growth and eventually, necessary reductions in entitlements and other government spending. There’s simply not enough money.



reduction from current levels. To lower this by just 2%, the taxpayers in the top two highest tax brackets would have to fork over 40% more than they are now paying. That gets us to 8% of GDP, not nearly enough to bridge the deficit gap even with an improving economy. Perhaps the only way to bridge the gap is to have everyone pitch in and raise government revenue with a broad-based VAT tax. As the second graph illustrates, a consumption tax of about 4% would bring in an additional 2% GDP of revenue (Sources CBO and Goldman Sachs estimates).

What is a “value-added tax” or VAT?

Simply put, it’s a national sales tax. A VAT is a tax on the transfer of goods and services that ultimately is borne by the consumer. The VAT has been used for decades to pay the bills and sustain the immense growth of governments around the world, from France to Mexico to Australia. Created in 1954 by a French economist, the VAT is the most potent, efficient machine for revenue generation yet invented. Highly visible, this tax would increase the cost of just about everything.

Why VAT?

It’s the only means of raising enough money to pay for massive increase in government spending along with the cost to finance much higher future interest payments on the federal deficit.

Former Federal Reserve Chairman Paul Volcker, now an economic advisor to President Obama, let the VAT cat out of the bag last week when stating that a value-added tax is less “toxic” than it once was. Hopefully the US is not yet predestined to the same elegant decay infecting most of Europe. VAT rates in Europe range from 6.5% in Switzerland to 25% in Denmark.

Fortune offered the following example of how the VAT could figure into the purchase of a car. Take, for instance, a car with a sticker price of \$30,000 and a value-added rate of 10%. Ford might buy its steel and other materials for \$8,000 plus \$800 in a VAT tax. A dealer then pays \$25,000 plus a \$2,500 tax for the finished vehicle. Ford takes an \$800 credit for the tax it already paid and sends \$1,700 to the government. A buyer then pays \$30,000 for the SUV and \$3,000 in taxes. The dealer collects the \$3,000, takes a credit for the \$2,500 worth of taxes already paid, and sends \$500 to tax authorities. Ultimately, the government pockets \$3,000, or 10% of the retail price of the car, in taxes.

Where will the money come from?

Taxing the rich won’t raise nearly enough revenue as the top graph illustrates. Remember that our deficits are running close to 10% of GDP. Sustainable deficits are thought to be in the 3% range so somehow we need a 7%

Just How Much Money is \$1.25 Trillion?

The following is an excerpt from John Mauldin's Outside the Box eLetter. He offers an excellent newsletter free of charge at johnmauldin.com

The Fed spent \$1.25 trillion on Mortgage Backed Securities (MBS) to support the housing market and these purchases resented 80% of the mortgage market. In today's financial headlines - the word Trillion is often casually thrown around. So much so, that it's easy to lose perspective on how much money this really represents. Picture a stack of \$100 bills. It might surprise you to know that it only takes a stack four inches high to be worth \$100,000. So \$1,000,000 would be a stack of \$100 bills 40 inches tall. How about a Billion? Well, you would have to stack \$100 bills up to the top of the Empire State Building...twice...in order to reach a Billion. So to picture \$1.25 Trillion represented by a stack of \$100 bills - that stack would be 850 miles high. If you could turn that stack on its side and were able to drive alongside it, it would take you longer than 14 hours to reach the end. If you laid those \$100 bills down side by side, they would travel around the world 50 times. We're talking about a lot of money here.

Past performance is no guarantee of future results. All content in this newsletter is intended as general information, not specific advice. Performance data listed is for illustrative purposes only. Portfolios are personalized and often consider many variables, including investment objectives, age, time horizon, risk tolerance, client requests and tax variables. Information contained herein has been obtained from sources believed reliable, but not guaranteed

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