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CAPITAL IDEAS

HELPING CLIENTS BECOME SUCCESSFUL INVESTORS

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QUARTERLY REVIEW (CONTINUED)

BY: DENNY BAISH

International and emerging markets fell much further than the domestic markets in 2008. After years of stellar returns, investors with foreign exposure saw unprecedented losses. The MSCI EAFE lost 43% of its value, while the S&P/IFCI Emerging Composite dropped 54%. Most foreign markets were unable to avoid the impact of the housing and subsequent financial crises in the United States.

The fixed income markets, generally, held up much better than the equity market. Government bonds provided some much needed safety for investors, out performing all others in the bond market and ended the year with positive returns.

Higher quality corporate bonds and municipal bond indexes experienced single digit losses in 2008. The high yield bond market suffered steep losses and provided no protection for investors, finishing down 27%. Overall, Treasury bonds were investors' only hope for positive returns in an otherwise dismal year.



QUARTERLY REVIEW

BY: DENNY BAISH

Investors are cautiously looking forward to 2009 after the major equity indexes posted steep losses last year (see chart below). The large-cap S&P 500 posted its worst calendar year return since 1931, and the small-cap Russell 2000 posted its worst calendar year return in its three decade history. The MSCI EAFE, an index that tracks international stock markets, lost more in 2008 than any other calendar year since its inception in 1969.

After a relatively benign first half, stocks sold off sharply in the fourth quarter, building on the selling pressure from the third quarter. The markets continued to worry about the worsening credit market, global recession, rising unemployment, a deteriorating housing market and falling consumer confidence, just to name a few.



In response to the worsening economic conditions, the Federal Reserve cut the Fed Fund's rate to between zero and a quarter percentage point. The Fed Fund's rate at the beginning of the year stood at 4.25%. The Federal Reserve also cut the discount rate, the rate used to loan money from

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the Fed to banks, to 0.50%. Statements from the Fed indicated that interest rates will remain low for some time due to poor economic conditions.

AFTER YEARS OF
STELLAR RETURNS, INVESTORS
WITH FOREIGN EXPOSURE SAW
UNPRECEDENTED LOSSES.

In looking at the domestic stock market for 2008, large-cap companies lost more than their mid-cap and small-cap counterparts, and value stocks posted better results than growth stocks for the year.

(CONTINUED ON BACK)

| BENCHMARK INDEXES | | |
|-------------------|-----------------------|--------------------|
| INDEX | FOURTH QUARTER RETURN | 2008 YEARLY RETURN |
| DJIA | -18.4% | -31.9% |
| S&P 500 | -21.9% | -37.0% |
| S&P MID-CAP 400 | -25.6% | -36.2% |
| RUSSELL 2000 | -26.1% | -33.8% |
| MSCI EAFE | -20.0% | -43.4% |
| LBAGG BOND | 4.6% | 5.2% |



QUARTERLY COMMENTARY

BY CHARLIE SMITH

*If it were done when 'tis done, then 'twere well
It were done quickly —Macbeth*

Last October, we lamented the allocation of the first round of TARP capital on political grounds rather than economic ones. We said the U.S. economy would suffer, perhaps as Japan has suffered, if weak banks were able to access taxpayer funding as readily as strong ones. Simply handing money to Zombie banks is a waste of both time and resources, and only prolongs economic pain. The financial system can reset itself (and lending can resume), only when the distressed assets of insolvent institutions are placed in the hands of healthy, well-capitalized competitors.

SIMPLY HANDING MONEY TO ZOMBIE BANKS IS A WASTE OF BOTH TIME AND RESOURCES, AND ONLY PROLONGS ECONOMIC PAIN.

Unfortunately, as politics has crept deeper into the capital allocation process, our ability to separate winners from losers has gotten bogged down. The initial \$350 billion in TARP money has disappeared into the maw of both well-run and distressed bank balance sheets with little noticeable effect. More months of steadily falling home prices and mortgage markdowns have brought us to a moment of truth. Several large institutions (Citigroup and Bank America included) face insolvency and need further taxpayer help. They not only need new capital, but they also need new leadership and entirely new business plans. They need to be broken up and sold off to stronger players. What they're likely to get, however (as part of TARP Two), are some of the same half-baked,

non-solutions that doomed TARP One. These include taxpayer-funded overpayment for bad assets, insurance for a gigantic pot of bad loans for a tiny premium and a "look the other way" attitude on executive compensation.

As with TARP One, taxpayers are unlikely to be happy with the result, which will be a continued slow bleed for the economy and the financial markets. The issue is very simple. Some of our largest lenders made bad decisions and now have assets worth less than their liabilities. We've chosen to guarantee their liabilities because the alternative (bank runs) could've brought down the financial system. Now we need to shut them down and revalue their assets (mortgage loans, mostly) at a level which makes paying off the loans less of a burden for overstretched homeowners. Furthermore, we need to get these newly revalued loans into the hands of well-capitalized competitors that have the ability to hold them to maturity.

This sort of plan will cost U.S. taxpayers a lot of money, perhaps as much as another \$1 trillion in up front investment. We can get it done quickly, and if we do, there is a good chance the financial system can reset itself and taxpayers can get a good portion of the money back over time. This is the Resolution Trust Corporation (RTC) model of the early 1990s, but on a much larger scale. The Federal Deposit Insurance Corporation (FDIC), which has plenty of experience in handling bank crises, could direct the process this time around. An FDIC paper written in 2000 and titled "The Cost of the Savings and Loan Crisis" put the number of failed thrifts at 1,043 for the years 1986-1995, with total assets for the failed banks of \$500 billion. The final net cost to the taxpayers was \$124 billion. RTC proved it can work. It can work again. We need to get started.

IRA'S & MINIMUM DISTRIBUTIONS

BY CHRIS CHANEY

WITH EACH NEW YEAR COMES NEW OPPORTUNITIES. ONE SUCH OPPORTUNITY ARRIVED AT THE END OF 2008 WHEN LEGISLATION WAS SIGNED INTO LAW SUSPENDING THE REQUIRED MINIMUM DISTRIBUTION (RMD) RULES FOR 2009.

This means that:

- If you are turning 70 ½ in 2009, you will **not** have to take an RMD in 2009.
- If you were already taking RMDs, you will **not** be required to take any distributions in 2009. This applies to all retirement accounts - including IRA, 401(k), 403(b) and 457 plans.
- If you inherited an IRA, you will **not** be required to to withdraw funds in 2009.

Please remember: this law is currently in effect for 2009 only. As a result, if you are subject to RMD rules, you will likely need to resume taking the appropriate RMD in 2010 unless Congress acts to extend the suspension.

While you will not be required to take distributions from your retirement account assets in 2009, if you need income from your portfolio in order to meet your living expenses you may continue to take withdrawals as necessary. But before doing so, we strongly recommend that you consider all of your options. If you have taxable investments, you may enjoy significant tax savings by taking withdrawals from non-qualified holdings in 2009.



If you have any questions about the tax implications of the Worker, Retiree and Employer Recover Act itself, you should contact your tax advisor. As always, Fort Pitt Capital Group continues to research opportunities that can help you realize your financial objectives. Given the options

available as a result of this legislation, we welcome the opportunity to talk with you and help you find the most advantageous way to meet your needs and goals in 2009 and beyond.

AS ALWAYS, FORT PITT CAPITAL GROUP CONTINUES TO RESEARCH OPPORTUNITIES THAT CAN HELP YOU REALIZE YOUR FINANCIAL OBJECTIVES.

TAX TIP: 1099 FORMS

Please be advised that the IRS has shifted the required mailing date of 1099 forms until February 15. This shift is in response to the significant number of corrected 1099 forms issued over the last few years. In order to avoid the need to file an amended return, we advise taxpayers to hold off on filing until they receive all of their 1099 forms.