

K M S

Client Quarterly

Winter 2009

Compliments of

Published December, 2009, by KMS Financial Services, Inc. *

2001 Sixth Ave., Suite 2801 • Seattle, WA 98121 • <http://www.KMSfinancial.com>

* Member: Financial Industry Regulatory Authority • Securities Investor Protection Corporation

Golden Opportunity, or Great Golden Bubble?

All that glitters is not gold, but the yellow metal certainly has been a-glitter this year. Among the factors behind the latest push into gold is a classic one: growing unease with major world currencies. Gold's rise has been most pronounced in U.S. dollar terms, but it recently broke out against all major currencies. Yields on high quality debt instruments offer a choice of low, lower, and lowest, so the "cost" of holding gold in terms of forgone interest is nearly nonexistent.

Monetary authorities of the world's most developed countries have been creating lots of money to beat back the deflationary effects of a global recession. They are loath to see their own currencies strengthen against others and dampen the competitiveness of their exports. Some of the developing world's most export-driven economies in Asia essentially tie their currencies to the U.S. dollar which has been hitting generational lows against the yen, the euro, the Canadian dollar, etc. Gold has emerged as a kind of "strong money," a store of wealth and a medium of exchange that pre-dates all of today's govern-

ment administered currencies by at least a few millennia.

Gold is also a commodity with a supportive supply-demand story. Annual production from the world's gold mines has declined incrementally for much of the past decade, while rising wealth across the developing world has provided new demand for the metal in any number of forms.

India is now the world's largest gold jewelry market, and it recently announced a deal to buy 200 metric tons of gold from the International Monetary Fund for \$6.7 billion. China also has doubled its gold reserves since the start of 2003 and may be another significant buyer of IMF gold in an effort to diversify its foreign exchange holdings away from the dollar without betting big on other major currencies.

It also has become much easier for retail investors to post a straight bet on gold to their portfolios. For years the choices were either inconvenient (holding bullion or coins); or volatile (shares of gold mining companies); or arcane and specialized (gold futures). But in recent years exchange traded funds (ETFs)

designed specifically to track the price of gold have taken up residence in many retail investor accounts and now represent a meaningful repository of the world's bullion.

This confluence of factors may drive more gains for gold, but it's also cause for caution. Nobody knows for sure when a trend is over-extended,

continued on page 2 ►

Tax Notes on Gold

As noted in the accompanying article, investors are finding it easier to establish positions tied to gold (or silver) prices through the growth of exchange traded funds (ETFs) designed for that purpose. But there are some tax considerations.

The tax code views gold and silver as collectibles rather than capital assets, so they don't qualify for the lower tax rates on long-term capital gains. Even if held for a year or more, any realized gains are taxed at as much as 28%.

This treatment applies to shareholders of gold and silver ETFs who are deemed to own undivided interests in the underlying metal. It applies to shares liquidated by the investor as well as gains distributed to shareholders due to the fund's liquidation of some of its gold or silver. On the other hand, the ETF vehicle can be particularly useful for IRA investors, providing an exception to the usual prohibition against owning collectibles in an IRA.

The foregoing does not represent an exhaustive discussion of the tax issues related to gold, silver, ETFs, or related vehicles. You'll want to check with your KMS Representative and/or tax advisor about your specific tax situation. ■

Who's Got the Gold?

Governments & Government Funds	Reserves in billions of \$	Governments & Government Funds	Reserves in billions of \$
United States	\$298.4	Netherlands	\$ 22.5
Germany	125.0	Russia	20.9
Internat'l Monetary Fund	118.0	European Central Bank	18.4
Italy	89.9	Taiwan	15.5
France	89.7	Portugal	14.0
China	38.7	India	13.1
Switzerland	38.2	Venezuela	13.1
Japan	28.1		

Source: World Gold Council's September 2009 report converted to US short tons at a rate of 1 T = 1.102311 US tons and calculated at the rate of 1oz gold = \$1042 US

Note: Governments are estimated to control about 20% of total global gold holdings.

The New Carry Trade: Gaming the Dollar

Two-and-a-half years ago the *Quarterly* commented on the “yen carry trade” then in vogue with global traders and speculators. As Japan’s post-bubble malaise extended well into its second decade, the country’s persistently miniscule interest rates had made the yen carry trade a pretty reliable way to lever up incremental returns.

Today the talk is about the *dollar* carry trade. A shaky U.S. recovery and historically low short-term Treasury yields are enticing traders to borrow in dollars to purchase a range of other assets. Global equities, high-yield bonds, gold, and other commodities have benefited (see the trailing one year numbers in the accompanying table).

This weighs on a U.S. dollar already under price pressure from the flood of liquidity released by the

Federal Reserve’s machinations and concerns over unprecedented federal deficits. With the Fed signaling that it will keep rates very low for an extended period, the dollar carry trade has looked like a one-way bet.

Such bets can sow the seeds of their own demise. Many of the assets reportedly benefiting from the dollar carry trade can be dumped rather quickly. And as we noted a couple years ago, “currencies can shift faster than the time it takes to profit on an interest rate arbitrage.”

Signs of healing for the U.S. economy could hit the dollar carry trade hard. Markets got a taste of the hair-trigger possibilities the other day when November employment numbers came in stronger than expected. The greenback rallied and gold gave up 4% on the day – not a game for the faint of heart. ■

U. S. Brands Still Pack Global Punch

Global markets have been dissing the dollar. But a wide-angle snapshot of any large currency trading floor is apt to show a can of Coca-Cola on at least a few desks. In a recent *BusinessWeek* article on the “100 Best Global Brands,” Coke topped the list with the world sipping more than a billion servings daily.

U.S.-based companies claimed eight of the top ten brands and 53 of the top 100. Other high-value brands included IBM, Microsoft, GE, McDonald’s, Google, Intel, and Disney. *BusinessWeek’s* ranking methodology stipulated that a brand “must derive at least a third of its earnings outside its home country, be recognizable beyond its base of customers, and have publicly available marketing and financial data.”

The *Quarterly* touched on this a decade ago in an article titled, “Are You a Global Investor? It’s Hard *Not* to Be,” noting some of these same companies’ substantial participation in growth opportunities across a broadening swath of the globe.

One reads a lot about a disconnect between Wall Street and Main Street. Part of that starts right here. Wall Street caters to many of these same major companies and an increasingly global clientele. It looks more and more like the recovery under way in many parts of the world will *not* be led by Main Street U.S.A. That may take some getting used to, but considering their high-profile global brands, leading U.S. *companies* may be rather underappreciated. And the main disconnect may be between those who have capital to invest, whatever street they live on, and those who don’t. ■

Investment Performance Review	TOTAL RETURN * (dividends and capital gains reinvested)			
	--- Annualized thru Dec. 4, 2009 ---			
Major Mutual Fund Categories *	1 yr.	3 yr.	5 yr.	10 yr.
Large-Cap Stocks (Core)	35.5%	- 5.4%	0.6%	- 0.2%
Mid-cap Stocks (Core)	48.6	- 5.6	1.5	4.3
Small-cap Stocks (Core) †	43.4	- 7.1	0.3	6.1
Foreign Stocks (multi-cap) †	52.5	- 4.4	4.9	4.3
Emerging Market Stocks †	97.8	3.1	14.0	10.8
Flexible Portfolio	29.5	- 0.2	4.0	4.6
General Bond	14.9	3.2	3.8	6.5
Int’l Fixed Income †	20.0	6.9	4.6	6.6
High-Yield Taxable Bond †	51.6	2.6	4.1	4.7
General Municipal Debt	18.1	2.1	3.0	4.5

* Source: Lipper, as reported in the *Wall Street Journal*, Dec. 5, 2009. **Past performance is NOT indicative of future results.**

† Small-cap stocks and high-yield (lower rated) bonds pose greater risk and price volatility than securities of larger, well-established companies. Securities of companies based outside the U.S. may be affected by currency fluctuations and political or social instability to a greater extent than U.S.-based companies.

► continued from page 1: Opportunity or Bubble...

at least temporarily. Gold’s first foray across the \$1,000-per-ounce line was in early 2008. By that fall it had dropped back to the \$700 range before embarking on this lat-

est surge past \$1,100. Long-time gold watchers point out that the price would have to at least double from these level to reach the peak, on an inflation-adjusted basis, of gold’s last great surge in early 1980. That does *not* mean it *will* approach such levels in this or any subsequent cycle.

We *do* know the historic ten-

dency for investors to pour into gold near the top of major price swings and bail out nearer the lows. The better approach may be to strive for a little more consistent exposure with the discipline to take some gains when they materialize then add back to the position in response to those inevitable corrections. ■

First Principles: Working with What We Know

All the work and worry dedicated to discerning the next direction for the stock and bond markets ends up telling us one thing: nobody really knows. But most of us *do* know that we must continue to accumulate assets toward a more secure retirement.

Among the most efficient ways to do that are the various tax-advantaged retirement plans available through one's employer or on an individual basis. Limits on contributions have edged ever higher over the past decade, and tax benefits are as important as ever – maybe more so given expectations of higher marginal income tax rates within the next couple years.

The accompanying table outlines 2009 and 2010 contribution limits for some of the most widely used tax-favored retirement plan vehicles. Which ones are available to you and how those limits apply is a good subject to check on with your advisor. There's still time to maximize tax-advantaged savings opportu-

How Much Can You Sock Away?		
Elective Salary Deferrals	2009	2010
401(k), 403(b), 457 & SEP	\$16,500 / \$22,000*	\$16,500 / \$22,000*
SIMPLE IRA	\$11,500 / \$14,000*	\$11,500 / \$14,000*
Personal IRA Contributions	2009	2010
Traditional & Roth IRA **	\$5,000 / \$6,000*	\$5,000 / \$6,000*
Employer Contributions	2009	2010
Indiv. 401(k) / SEP IRA	Lesser of \$49,000 or 25% of compensation***	Lesser of \$49,000 or 25% of compensation***
* Higher amounts are for individuals 50 or older. Source: The Money Alert		
** Income limits may apply to Traditional IRA deduction and Roth IRA contribution.		
*** Maximum considered compensation is \$245,000.		

nities for 2009.

If the past decade has taught us anything it is that high rates of return cannot be assumed, and

that saving early and persistently is critical in turning volatility to one's advantage and achieving real wealth accumulation. If the government wants to help, all the better. ■

Inflation-Linked Bonds Go Global

These pages first covered inflation-linked securities in 1997 when the U.S. Treasury re-introduced them into the mix of federal debt issuance. Treasury inflation protected securities (TIPS) have become a staple for institutional fixed income portfolios looking to guard against the potential hit to conventional bond values from any kick-up in inflation.

TIPS are issued with a stated coupon rate like ordinary Treasury securities, but the underlying principal value is actually adjusted based on the inflation rate, and coupon interest is then figured on that adjusted principal. Principal also can adjust *downward* in a deflationary environment, but a TIPS bond held to maturity should return *at least* the originally issued face amount.

These days the U.S. isn't the only major government borrowing buckets of money and triggering fears of future inflation. The U.K., Japan, and France are among the sovereign issuers of inflation-linked bonds. Demand has been healthy, and since the bonds can be sold with a lower coupon than conventional bonds of

Going "Green" with Your Statements & Confirmations

How about a New Year's resolution to exercise some environmental stewardship with your brokerage account? In 2007 KMS announced the option of forgoing *paper* statements and confirmations in favor of online delivery. You can make that choice any time through the online account access at www.netxclient.com or www.netxview.com.

Your document choices are presented in the Account Profile section once you've logged in at the site. You can switch options as desired, which may come in handy if you prefer paper when you're home but would rather shut it off when you travel.

When you suppress paper statements and confirms you still receive an e-mail notice whenever one of those documents becomes

comparable maturity, they save the issuing governments interest costs, at least for the time being.

Longer term these bonds might be added to a growing list of obligations their issuers will find especially

available online. The NetX sites also provide a ready archive of past statements and confirms.

You also can shut off the mailed copies of annual reports and proxy statements for the securities you hold in your account. This is facilitated through Broadridge Financial Solutions at www.icsdelivery.com. Simply register once per account, and all eligible communications are then delivered online. You'll still receive hard copy from any company that does not participate in Internet delivery.

Whichever way you elect to receive your statements and confirms, we encourage you to monitor the information on a timely basis. If you have questions about pursuing the paperless path for 2010, your Representative can assist. ■

challenging if sustained inflation does in fact take hold. In the meantime investors seeking some directed inflation protection in their fixed income portfolios have additional tools to work with. ■

Fair Is Fair, but What's Fair?

There's a lot of talk these days about excessive compensation and inequality of incomes. Some of the numbers are eye-popping and prompt us to ask how much of a gap is *too* much between the economy's biggest winners and the rest of us "also-rans."

This is an abiding conundrum for any dynamic economy, as that dynamism drives outsized rewards for top-tier performance. The ascendancy of mobile human capital over assets like land and material resources in creating and capturing wealth is a *very* long-term trend.

Take, for example, another figure in the news of late: Tiger Woods. The golfing legend and global sports icon's 2009 tour winnings totaled \$10.5 million. En-

A Little *Under-Cover* Economics

Here's an economic indicator with some *legs*: men's underwear sales. The theory *behind* it is refreshingly *brief*. Most of the time underwear sales show steady but unspectacular growth. An economist would say that demand isn't very *elastic*. But when times get really *tight*, guys try to *stretch* the useful life of these items, and sales *shrink*.

Sales growth did indeed start to *sag* last year, and may actually

contract for 2009. Buyers also have *shifted* to cheaper brands. One's underwear is relatively invisible to others, so it's an easy place to *skimp*.

Nevertheless, we've probably seen the *bottom* for this cycle. By late summer some big retailers saw sales *creeping* back up, perhaps a function of pent-up demand. And with women often influencing the buying decision, a *snap-back* in men's underwear sales was bound to be in the *offing*. ■

dorsements, appearances, and other enterprises pushed his total income over \$100 million. Yet Mr. Woods' season average of 68.05 strokes per round was only two strokes better than John Senden, a mid-tier touring pro who bagged a career-best \$2.3 million plus his share of perks and freebies. Mr. Senden's winnings, in

turn, dwarfed the pay of an established pro at a prestigious golf club.

We tend to accept such huge discrepancies when performance standards are transparent and objective. We also recognize that the rewards accruing to a Tiger Woods are a boon rather than a detriment to his colleagues competing on the links at all levels.

Defining clear and measurable benchmarks for the performance of CEOs at large, complex companies keeps an army of consultants busy. As in sports and entertainment, business trends and circumstances change. This season's star CEO can become tomorrow's symbol of unbridled greed and/or incompetence. The stellar candidates to replace the poor sot will want to be well-compensated for climbing up on that high wire. It can be a short walk followed by a long fall. ■

For information on any of the items listed below, please call:

or the KMS Home Office: **(206) 441-2885, ext. 0**

- Mutual Funds, Unit Investment Trusts, & Exchange-traded Funds
- Individual Stocks and Bonds
- Private Portfolio Management
- Life Insurance & Annuities
- Online Access to Your Accounts
- IRAs and Tax-qualified Retirement Plans
- "529" College Savings Plans
- Insured Certificates of Deposit