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Mid-Quarter Outlook

By John M. Silvis, CFA
Director of Investments

The equity markets continue to build off of last year's strong finish with the S&P 500 Index returning 2.4% in the month of January. JP Morgan did an interesting study recently that bodes well for the rest of the year. They found that after an up month of December during bull markets (remember that the equity markets returned 6.5% during December 2010), the following full year performance is up 91% of the time with an average return of 19.4% for the S&P 500 Index.

Several factors have contributed to the fast start this year. With over 75% of companies already reporting earnings for the fourth quarter, returns have been strong both on the top line (revenues) as well as the bottom line (earnings) boosting confidence that the economy is indeed shifting gears and entering what could be a long expansionary phase. Corporate Mergers and Acquisitions (M&A) activity has been robust during the beginning of 2011 with many companies spending their cash hordes on better growth prospects going forward. Stock buybacks have increased and, more importantly, spending on capital equipment and infrastructure is improving, driving demand for big ticket items.

Investors continue to pour money into equity funds, as measured by the ICI, reversing a trend of outflows for most of 2010. This should be the beginning of a longer term trend, as investors have more confidence in the economy going forward. On the flip side, investors reduced their holding of municipal bond funds taking a more cautious view towards state and municipal debt.

Fourth quarter GDP growth for 2010 finished strong at 3.2% causing many economists to revise upward forecasts for 2011. According to Bloomberg, the median 2011 estimate has been revised to 3.5%, indicating stronger growth going forward. Inflation remains subdued here in the U.S., with unit labor costs remaining low, holding down the final prices of goods and services.

Many concerns still remain as political unrest escalated during the first few weeks of the year. Both Tunisia and Egypt had popular uprisings leading to political change. Should this spread to other parts of the Mideast region, further volatility to the supply and price of oil could cause disruptions to the global expansion. Commodity prices have been climbing, causing prices in many emerging markets to rise driving the cost of necessities such as food higher.

Finally, we believe that a correction in the coming weeks or months should be expected. Ned Davis Research, using data going back to 1928, calculates that corrections of 5% happen on average every 50 days regardless of a bear or bull market. We have currently gone over 125 days without a correction of 5%.

Fairport Global Asset Allocation

With earnings pushing equities higher, the domestic equity markets have pulled ahead with Mid Caps leading the advance. Small Caps are leading the international developed markets but trailing domestic Large Caps. Emerging market equities have struggled under the threat of higher inflation and political unrest starting the year in the red, with the MSCI Emerging Market Index down over -6%. Europe, benefiting from a lull in their debt crisis, has booked positive gains so far this year. However, we remain cautious while acknowledging things may be incrementally getting better for the continent.

Fairport Large Cap

We continue to believe we are well-positioned to benefit from the improving economy going forward and have positioned our model to take advantage of what we believe will be a cyclical bias relative to the defensive sectors. We remain overweight Industrials, Technology, Energy and Materials while underweight Utilities and Financials. Many Wall Street strategists have increased their earnings target for the S&P 500 Index to an average of $97 indicating further upside using historical multiples.

Fundamentals remain strong and the economy continues to improve, putting the wind to our backs.

Fairport Fixed Income

The recent surge in yields has brought the 10-year Treasury back near fair value, at 3.62% (according to Ned Davis Research, fair value on the tens is 3.60%). The Fed remains committed to keeping interest rates low, and we fully expect them to see the QE2 program to completion, purchasing all $600 billion in Treasuries. We remain overweight spread product, and favor high yield which continues to outperform, climbing to record return levels relative to investment grade bonds and Treasuries. Driven by strong balance sheets and improving fundamentals, high yield spreads have dipped below 500 basis points for the first time since November 2007.

Municipal bond fund outflows hit an all-time peak of -$4.002 billion for the week ending January 11, 2011. As of February 2, 2011, outflows have lessened significantly, improving to -$1.069 billion. Key support has been provided by a combination of purchases by crossover buyers and extremely light new supply. Looking ahead, a heavier calendar could push spreads higher on medium quality paper. That being said, we do not expect a significant rebound in tax-exempt issuance before April. The municipal yield curve remains historically steep, and we continue to target high quality issues in the intermediate part of the curve.

Client Question

Each quarter, one of our professionals will answer a question asked by a Fairport client.

"With the new Tax Act, do I no longer need to worry about estate planning if my net worth is less than $5 million ($10 million for married couples)?"

By Peter P. DeVito, CPA, CFP®
Vice President & Advisor

The most important issues in estate planning are almost always people issues, not tax issues. Even if there were no estate and gift taxes, you will still want to ensure that your assets go to the people or charities you choose in the manner you decide. The only way to do this is with estate documents designed specifically for you.

The new $5 million increase could actually cause results you no longer desire: too much of your estate being restricted, inadvertent disinheritance of a spouse, creating unfavorable income tax results for beneficiaries, etc. Also, your estate plan is "fixed in time," but financial and family situations change, so it is important to meet with your estate planning attorney to review, and if necessary to update, your overall plans on a regular basis.

Keep in mind the new Tax Act expires in only two years. At that time, you will only have an estate tax/gift tax free amount of $1 million unless the law is changed again. See below to learn more about estate changes in the new Tax Act.

Impact of the 2010 Tax Act on your Estate, Gift and GST Tax Issues

The "Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010" (the "Act") is complex, and this only highlights features that are important to Estate, Gift and Generation-Skipping Transfer Tax ("GST Tax") planning.

The Act expires in two years, and there is no way of knowing what Congress will do in the future. The next two years offer opportunities to anyone with a significant estate or who might otherwise want to make substantial gifts to children, grandchildren or others. We strongly recommend looking at how these opportunities might work for you in the near-term.

1. **Estate Tax Free Amount Increased**: The Act increases the amount a person can leave at death without being taxed (the "Estate Tax Free Amount") to $5 million dollars per person ($10 million per married couple) for 2011 and 2012 (indexed for 2012), but this expires as of January 1, 2013 unless yet another tax act is passed in time.

2. **Gift Tax Free Amount Re-Unified with Estate Tax**: The Act re-unifies the Gift Tax Free Amount and the Estate Tax Free amount at $5 million per person but only for 2011 and 2012 (indexed for 2012). *This makes 2011 and 2012 excellent times to make significant gifts*.

3. **Estate Tax Free Amounts are "Transferrable" to Spouses upon Death**: Estate Tax Free Amounts are "portable" for married persons where one spouse dies before January 1, 2013. If a person dies leaving $3 million in assets (without reaching the full $5 million Estate Tax Free Amount), the $2 million balance will carry over to the surviving spouse. However, if the surviving spouse remarries, his or her Estate Tax Free Amount could change again in certain circumstances.

Appreciation on the deceased spouse's unused Estate Tax Free Amount is not counted. The purpose of a "by-pass" or "shelter" trust is to keep future growth from being subject to *estate* taxes. Accordingly, if a deceased spouse left $3 million in an estate tax sheltered trust for the lifetime of the surviving spouse and the value grew to $4 million by the time the surviving spouse died, the $1 million in growth would also be sheltered from estate taxes. However, the carryover Estate Tax Free Amount from the deceased spouse would stay fixed, regardless of growth in asset values, and is not indexed for inflation.

The portability features of the Act are available ***only*** if a deceased spouse's estate files an election for portability on a timely filed U.S. Estate Tax Return, even if the return would not otherwise be required.

4. **New Maximum Tax Brackets**: The new maximum tax bracket for estate, gift and GST taxes is 35%, but the maximum brackets will revert to 55% on January 1, 2013 unless a new tax act is in place by then.

The Act also opens broad opportunities for shifting future growth out of the estate tax system by any number of gifting mechanisms. This is particularly important for persons contemplating substantial gifts prior to December 31, 2012.

Finally, do ***not*** make the mistake of thinking no planning is needed if you do not have estate tax exposure. Some of the most important reasons for planning include avoiding probate and what kind of legacy you will leave: who is to make medical and financial decisions if you are unable and financial decisions when you are gone; who is to inherit what and when and under what conditions; and who is to care for young children or special needs family members.

Fairport News
Read about our most recent accolades, community involvement and continuing education.

Fairport is delighted to have been recognized recently by *Investment News* as one of the Top Financial Planners in the country.* We thank you, our clients and friend, for your support and loyalty!

Emily Drake was the guest speaker at WIN (Women in Networking) Cleveland's monthly meeting in February. She presented Solutions for Women®, Fairport's signature program that aims to enlighten women on investing, financial planning and socially responsible philanthropic giving.

Heather Ettinger's study group, Family Wealth Advisor Council (FWAC), is in the process of conducting a confidential national survey of influential women. The goal of the brief electronic survey is to gain insight into women's wealth advisory needs and preferences. The goal is reach 500 women in all 50 states! The results will be published in a research paper this spring. If you, a family member or friend is interested in participating in this exciting survey, contact heather.ettinger@fairportasset.com.

Laurel Lawrence is leading an employee volunteer trip to WSEM's Food Center of Excellence at Brookside in Cleveland at the end of the month. WSEM's food centers provide 750,000 meals a year to more than 45,000 individuals. The Fairport volunteers will spend a day helping to bag and stock food at the center. They will also bring canned goods/boxed food items donated by Fairport employees.

Tom Seifert was nominated to serve on the Gesu Parish Endowment Board.

Emily Shacklett is doing board shadowing for Mental Health America of Summit County. She is also working with 6 students from various high schools in the Akron area on a presentation project for Junior Leadership Akron (JLA).

Newsletter Disclosures
This newsletter represents an assessment of the economic and market environment at a specific moment in time and is not intended to be a forecast of future events or any guarantee of future results. It is for informational purposes only and should not be relied upon as research or investment/financial planning/tax advice. It should not be considered as a solicitation or recommendation by Fairport to buy, sell or continue to hold securities or other investments. Past performance is not a guarantee of future results, and is not indicative of any specific investment. It should not be assumed that the investment process and strategy discussed herein has been or will prove to be profitable. Diversification and strategic asset allocation do not assure profit or protect against loss in declining markets.

**Investment News* published in its December 2010 issue a listing of the Top 30 Financial Planners conducted by RIA Database, a Charlotte NC based company that focuses on providing accurate, relevant data for sales professionals on registered investment advisors. The national ranking is based on discretionary assets under management as of September 30, 2010. RIA Database qualified and ranked investment advisers based on the following criteria: 1) They must have a significant number of financial planning clients 2) Greater than 50% of their business must serve the individual investor marketplace 3) They must not be doing business as a broker-dealer or a bank 4) A dominant portion of their business must not be invested in proprietary products or managing proprietary products.