

## 2008 Full Year Investment Letter

### 2008 Market Overview

In the year 2000 George Clooney starred in a movie called the Perfect Storm. It told the story of the "Andrea Gail" a fishing boat out of Gloucester, Massachusetts that endured a weather event that had never occurred in recorded history. There was a happy ending to the story and thankfully that ending wasn't just Hollywood taking their customary creative liberties. It's very likely you know why we start our 2008 Investment letter with this bit of cinema nostalgia. The year just past brought economic crises, a financial perfect storm, and the recession that began in December of 2007. The S & P 500, which measures the performance of US based large company stocks, finished 2008 down 37.5%, its worst performance since 1937. The story was even worse for diversifiers and international stocks as represented by the following broad market indices:

Market Indices	2005	2006	2007	2008
S & P 500	4.9%	15.8%	4.9%	<b>(37.5%)</b>
Russell 2000 <sup>1</sup>	4.6%	18.4%	(1.6%)	<b>(33.8%)</b>
MSCI EAFE <sup>2</sup>	15.7%	23.5%	11.2%	<b>(45.1%)</b>
MSCI Emerging Markets <sup>3</sup>	30.3%	29.2%	36.5%	<b>(54.5%)</b>
Wilshire REIT <sup>4</sup>	14.0%	36.1%	(17.6%)	<b>(39.2%)</b>
Lipper Natural Resources <sup>4</sup>	n/a	n/a	n/a	<b>(49.0%)</b>
Lipper Emerging Markets Bond <sup>4</sup>	13.8%	12.3%	5.9%	<b>(20.1%)</b>
Barclay's Global Bond Aggregate	4.8%	4.4%	6.6%	<b>5.1%</b>

<sup>1</sup> This is the US Smaller Cap index

<sup>2</sup> This is the broad International index covering Europe, Australia and Far East markets

<sup>3</sup> This is the index covering global emerging economies

<sup>4</sup> These indices represent Northstar's Diversifier Asset Class



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Bonds in your portfolio provided a cushion, as you'd expect, however the level of relief was less than expected for all but US Government bonds. For example, a diversified portfolio of US Investment grade corporate bonds, those with the strongest credit ratings, spent much of 2008 down more than 10%, a very rare occurrence, as investors flocked to the safety of US Government bonds. The year brought other historic events such as the beginnings of a run on money market funds, an event scary enough for our government to intervene and temporarily guarantee money market deposits. What washed ashore with the financial perfect storm in 2008 was an environment where the benefits of diversification, though still present, were significantly muted.

But the news is not all bad. While we won't pretend any ability to predict exactly what 2009 will bring, we do expect a better year ahead. Our Federal Reserve, Treasury, and new administration have all made clear that they are committed to fixing the real problems our economy faces. Central banks throughout the world are displaying similar commitment to the significant global economic problems. While those efforts come with no guarantees, they have already shown signs of helping financial markets. For example: credit markets continue to show signs of healing, mortgage rates have come down helping the housing market, and world equity markets are up double digits over the last 60 days. Additionally, stocks are relatively inexpensive when compared to fixed income alternatives and there is a very high level of cash on the sidelines. These are all positive signs and since the stock market is a forward looking vehicle, we should see signs of a market recovery as the influx of government spending begins to stabilize the economy.

With that broad market background, the 2008 total returns for the Northstar Model Portfolios were:

2007	Northstar Model Portfolio Return	2008
6.40%	Aggressive (90% equities/10% bonds)	(36.82%)
6.46%	Capital Growth (80% equities/20% bonds)	(32.34%)
6.52%	Balanced Plus (70% equities/30% bonds)	(27.87%)
6.59%	Balanced (60% equities/40% bonds)	(23.38%)
6.65%	Conservative Balanced (50% equities/50% bonds)	(18.98%)
6.72%	Capital Preservation (40%/60% bonds)	(14.45%)

It is important to remember that your specific investment mix will differ from the unmanaged indices that are used to represent the asset classes that make up our Model Portfolios. For some people, their investments may include legacy stock or mutual fund positions that are being maintained for tax or personal reasons; for others perhaps it is long term municipal bond holdings designed more to generate



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tax-free income. In some cases, the timing of our annual re-balancing of your portfolio can create short term deviations from the model that tend to smooth over multiple year periods. Whatever the case, the Model Portfolios are hypothetical targets and are intended to indicate an ideal for an investor with a specific time horizon and risk & return profile.

We strongly believe that as your wealth manager, Northstar principals should have their wealth riding along with yours. This demonstrates our commitment to you and conviction to our investment process. We eat our own cooking at Northstar and experienced the same difficult year in the market as you.

### **Risk and Return**

It is obvious that risk surrounds us in the investment world. Risk is listed in every prospectus, measured on the snapshot page of any mutual fund, highlighted in the small print, and a main focus of client/advisor discussions. While it is easy to overlook risk's role in fair-weather economic conditions, stock market volatility took center stage in the past year, challenging investors' tolerance, and causing many investors to question past judgment. It is difficult not to take pause at the red numbers streaming through today's headlines, but investors are wise to remember that risk is meted out over time, and this too shall pass.

It is our philosophy that the level of risk inherent to a portfolio must be determined based on investor tolerance and length of time available to reach goals. Attempts to avoid investment risk will only yield minimal returns, thereby putting the investor at greater risk of not attaining financial goals. Since markets inherently fluctuate, longer investment time frames are optimal because they provide the opportunity to take on higher risk. Over time, market highs and lows will absorb each other to create a steadier yield on investment.

To demonstrate the effect of long-term planning, observe the historical total returns of many mutual funds. For example:

<b>Mutual Fund</b>	<b>1 Year (2008)</b>	<b>3 Year</b>	<b>5 Year</b>	<b>10 Year</b>
DFA US Small Value Fund	-36.79%	-11.81%	-1.51%	7.32%

In today's market, the trailing one-year return is startlingly low, thereby causing negative results in the three year annualized return as well. Yet note the upswing that begins to take place upon examining the five- and ten- year annualized total returns. The greater returns at the far end of the spectrum are essentially absorbing the risk associated with the current market downturn. In view of this, while past



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performance is no guarantee of future returns, current short-term absorption of risk is expected to open potential to greater long-term returns.

Consider this: research conducted by Morningstar shows that it took a lingering two years for the market to regain its position following the 1987 downturn. However, the market's peak in 1990 showed a 64% gain above the lowest point of decline in 1987. The silver lining of the current financial downturn is that it gives rise to the profitable opportunity to buy low and sell high when markets eventually bounce back.

It is futile to attempt to time the market's rebound, but history has proven the power of capitalism to channel resources over long-term periods for the attainment of wealth. Markets fluctuate, and corrections may be slow in passing, but the long-term economic future is positive. Now is the time to deny knee-jerk reactions to panic, and reaffirm your risk tolerance and long-term financial plan for a brighter future.

### **Financial Life Planning**

Your team at Northstar is paying particular attention to the interplay of evolving world market events and their potential impact on your financial plan. We understand that the market returns combined with the recession may pose challenges (loss of job, cash flow changes, delayed retirement, career change etc.) that require some adjustment to your planning.

As part of our annual renewal meeting, we will be reviewing all aspects of your financial life plan to determine if adjustments are needed. These include your personal and financial life goals, retirement projections, cash flow and emergency funds, security of employment income, savings plans, company benefits plan, asset allocation and risk tolerance. This information is the foundation for your investment strategy and any changes will be incorporated therein.

Finally, we see the recent market events as an opportunity to help our clients continue to focus on their life plans where true success is measured not only by monetary wealth, but through deeper life values, such as family and friends, community and faith.

### **Tax Changes for 2009**

2009 is an important year for some clients over the age of 70 ½. Congress has passed legislation that waives the obligation to take a Required Minimum Distribution (RMD) from your IRAs in 2009 *only*. If you don't need the income, this is a change you may wish to take advantage of because having the RMD remain in the



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IRA provides continued tax deferral, may lower your 2009 tax obligation, and avoids the necessity of selling IRA assets that may have gone down in value. Of course, you retain the option to withdraw your RMD from your IRA that would be subject to normal taxation.

401(k) contribution limits for 2009 increase to \$16,500 or, if you were born before 1960, \$22,000.

This year, the estate tax exclusion rose to \$3.5 million, in 2010 it will disappear altogether and then in 2011 it returns to \$1 million. It is expected that President Obama will push Congress to change the law to keep the exclusion at its current \$3.5 million. The annual gift exclusion is \$13,000 in 2009.

We have enclosed your first quarter 2009 invoice for our services. Please call if you have any questions. Also, if there have been any significant changes in your financial, health or personal situation or a change in your life goals, please contact us to review the possible impact on your financial life planning and wealth management strategy.

Thank you for your continued trust during a very turbulent year. We wish you and your family a healthy and prosperous New Year!

Warmest Regards,

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