

### Special points of interest:

- Emerging markets led 2009 rally.
- “Stock selection is likely to weigh heavily in 2010”
- “Rebalancing helps preserve an asset allocation plan over time”
- Individual donors may gift \$13,000 per donee in 2010
- 90% of performance is based upon asset allocation

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## A Look Back at 2009

Despite a new president, an economic recession, government bailouts and stimulus spending leading to huge government deficits, and a falling US dollar most asset classes rallied. 2008 ended as a losing year for stocks. On January 1, 2009 the S&P 500 (iShares S&P 500 “IVV”) stood at 904.4 down 39% for CY 2008. The economic mess continued to weigh on the markets with the S&P falling another 16% by March before finding support. Central banks pumped liquidity into world economies and much of it

found its way into precious metals and stocks. From its March lows, domestic stocks rallied with the S&P rising from 672 to over 1112 by late-December; a gain of over 65% (over 24% for the year). International stocks, especially emerging market stocks participated. In fact, one could say, led the way. From its March low, the iShares MSCI Emerging Markets Index, “EEM” soared over 100% (over 65% for the year). Gold saw its low for the year on January 2, at \$862 per ounce and never looked

back. The precious metal rallied to near \$1190 before shedding approximately \$125 per ounce. Never-the-less the metal shone bright, gaining some 24% for the year. Real estate stocks as measured by the iShares Cohen & Steers Realty Index, “ICF” underperformed on a relative basis. From its March low at 23.04 the Index rallied through year-end to gain about 20% for 2009. Despite respectable rallies for all asset classes, with the exception of gold, none have regained or surpassed their 2007 highs.

## A Look Forward to 2010

2010 looks a bit different than 2009. Much of the panic that ushered in last year and drove assets to undervalued levels has past. In 2010, central banks are unlikely, or unable, to add any additional liquidity. In fact the question is when will liquidity be withdrawn? In addition cost-cutting has yielded strong earnings improvement despite a tepid economy. Analysts generally forecast 2010 GDP growth at about 3.5%. Despite the muted recovery, the alternatives to stocks are not enticing. Cash returns of

zero and bond yields that are low by historical standards suggest that the equity asset class looks good for 2010. However, stock selection is likely to weigh more heavily into performance than last year. The basic materials sector which performed well in 2009 is expected to remain strong. Industries with probable upside include aluminum, chemical, and steel names. We also view the technology sector to be poised for sector-wide revenue growth of 8%. Emerging market securities are likely to con-

tinue to outperform developed economies. Within the emerging market economies, we favor Russia, Latin American, India and certain Chinese companies including Baidu, the largest Chinese internet search engine. We continue to see pressure on real estate prices and remain under-weighted. In the commodity sector, the outlook for most metals remains positive while agricultural prices remain under pressure. We remain market-weighted in the sector and over-weighted in precious metals.

## The Asset Allocation Process

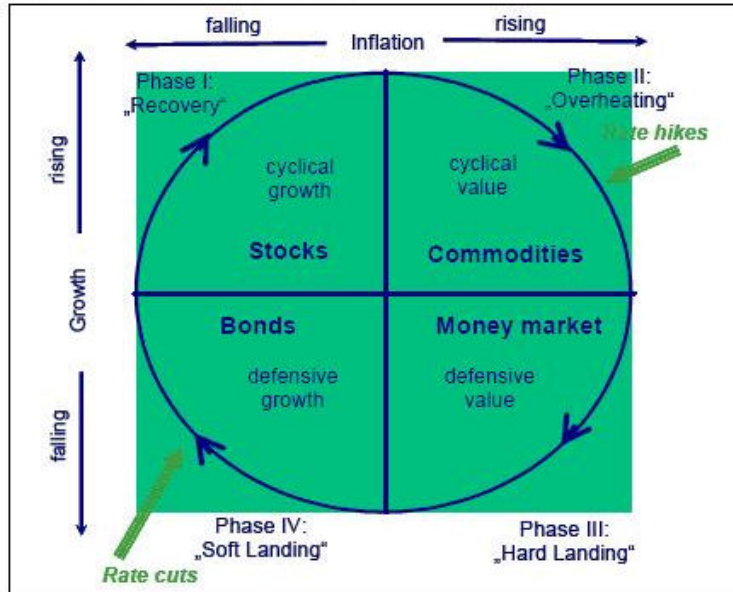
Asset allocation is the process of combining securities from different asset classes such as domestic stocks, foreign equities, fixed income, commodities, and cash equivalents to create a diversified portfolio. Since different asset classes have different risk and return characteristics and are not perfectly correlated there are potential benefits by combining them into a single portfolio. There are a number of different asset allocation strategies including Buy and Hold, Strategic, Insured, Tactical, and Integrated.

Stark Financial relies upon an integrated approach. This approach incorporates both changes in capital market assumptions and investor risk tolerances. Target mix allocations are updated accordingly. The integrated approach is the most comprehensive and it is also the most difficult and resource-intensive to implement. The tactical element in particular involves adjusting the portfolio's target allocation to reflect shorter-term capital market expectations for different asset classes.

The goal is to reduce exposure to asset classes that have appreciated beyond a fair value estimate with the proceeds being reinvested in asset classes deemed undervalued. By attempting to anticipate changes in the relative value of different asset classes, we seek to

Asset allocation and rebalancing play important roles in achieving and maintaining diversified and disciplined portfolios. There are a number of potential benefits. Investment risk is reduced because the growth opportunity is not limited to the performance of one security, but is

impacted by the opportunities presented by a collection of securities. Investing in a broad selection of securities across a variety of asset classes can help reduce volatility. Since asset classes are not



***“Determining a personal asset allocation plan depends on an investor’s unique set of financial needs and goals”***

benefit from adjusting the portfolio mix before these changes occur. The investor’s risk tolerance is assumed to be stable over the investment horizon regardless of the level of wealth. Periodically rebalancing the asset allocation is important because the process identifies and corrects any deviation from the original asset allocation strategy. It is also the way in which changes in capital market assumptions or the investor’s risk and return preferences are incorporated into the portfolio.

perfectly correlated an asset class performing poorly in the short-term can be offset by one performing better (for example, stocks and commodities generally have a negative correlation). This helps reduce volatility during turbulent times. Finally, the process offers greater investment discipline which in turn increases the chance of achieving long-term investment objectives. A word of caution, asset allocation and rebalancing do not guarantee profits and losses can occur.

## Total Return Investing

Do not confuse a cash distribution from a stock or bond as its return. If a stock or bond pays you a 5% dividend but lost 10% of its value in the last year, you have lost 5%. To get the true return you must con-

sider the change in price of an investment plus any income. For example, a utility stock that paid a 3% dividend and rose 7% in price would have had a 10% return. Remember, a security that pays a high

distribution is not necessarily the best investment. If income is your objective, build a portfolio with a conservative mix and plan your distributions based upon the portfolio’s total return, not upon the dividends and interest received.

To the extent possible, it's a good idea to make the maximum contribution to whatever qualified plan you participate in. For 2010 the maximum contribution limit for IRAs remains \$5,000. In addition if you are over age 50 you can make a \$1,000 catch-up contribution. For SEP plans the maximum percentage of compensation that can be deposited is 25% subject to a \$49,000 limit. If you participate in a Simple IRA you can contribute up to \$11,500. In addition if you are over age 50, you can contribute an additional \$2,500 as a catch-up contribution. The ability to deduct IRA contributions depends upon marital status, income, and whether one or both spouses are covered by a qualified plan. For traditional IRAs, if both spouses participate in a qualified plan, the ability to deduct contributions phases-out between \$89,000 and \$109,000 of income. If only one spouse

is covered by a qualified plan, the phase-out range rises to \$167,000—\$177,000. If you are single the phase-out range is \$56,000—\$66,000. For Roth IRAs, if you are married and filing jointly, the phase-out range for contributions is income of \$166,000—\$176,000. The range for single taxpayers is \$105,000—\$120,000. During 2009 the requirement to take a required minimum distribution was waived. The RMD has been reinstated for 2010. If you are over 70 1/2 and have an IRA you must take a RMD. If you participate in a 401(k), 403 (b) or 457 plan, your maximum elective deferral to the plan is \$16,500. Over the age of 50 you can make a \$5,500 catch-up contribution to if you participate in a 401 (k). Unless Congress changes the law, the top gift tax rate falls to 35% from 45%. The annual gift tax exclusion allows for individ-

ual donors to gift \$13,000 per donee tax free. The Estate tax has been repealed for 2010. Under the current law, the estate tax will be reinstated in 2011. Estates over \$1,000,000 will receive a tax credit of \$345,800 and will be subject to a tax on the adjusted estate of 55%. If you are thinking of retiring with full Social Security benefits you must be 66 years of age or older. You can start to receive social security at age 62 but, you will only receive 75% of the benefits available at age 66. If you continue to work after beginning to receive social security benefits, your benefits could be reduced. Before full retirement age (66), you will lose \$1 of every \$2 of earnings over \$14,160. After full retirement, there is no limit on what you can earn. If you realize a capital gain in 2010, unless your income bracket is 15% or below, you will pay a capital gains tax of 25%.

***“IRA required minimum distributions have been reinstated in 2010”***

## Thoughts on Security Selection

Studies have shown that over-time 90% of performance is based upon an account asset allocation. However, it only explains about 40% of the variation among individual securities. Clearly, the optimum portfolio structure is not enough to maximize performance. The security selection process begins by properly characterizing each security base asset class and style. For instance Apple, Inc. is best described as Domestic Equity, Large Cap Growth. The benchmark index that we would measure this security against would be the S&P 500 Index. Mutual funds are not as easily characterized. The Lord Abbett Small-Cap Value fund for example has a portfolio that has .64% invested in large-cap stocks, 23.10% invested in mid-cap stocks, 69.84% invested in small cap issues, 1.68% in non-domestic developed stocks, 2.33% in cash and 1.76% in REITs. While the majority of the portfolio is invested in small-cap

stocks, a large portion of it is not. We would invest in a fund such as this only when a better small-cap alternative was not available. This type of constraint often arises in employee sponsored retirement plans, or within variable annuities with limited investment options. Where possible we generally use individual securities or Exchange Traded Funds through which we can better target a specific sector. Starting with a sorted list of securities, those within a specific sector are compared against a number of technical indicators such as; the securities benchmark, its momentum, and its price in relation to its moving average. For example SPDR Gold Trust/GLD, at 108.06, is trading above its benchmark, the Powershares DB Commodity Index Tracking Fund. It is selling below its 20-day moving average at 114, and is showing negative momentum comparable to March of 2009. Chances are that gold is a buy.

Fundamentals also must be taken into consideration. For stocks earnings momentum is important. We look for accelerating earnings, increasing earnings forecasts, and positive earnings surprises. With fundamental data in hand, we then form a judgment as to current valuation and prospects for price appreciation. Using these criteria, sectors such as basic materials, technology, and energy look like good choices for 2010. Having completed these steps, selected securities are then added to individual portfolios in the appropriate size to assure proper diversification. Diversification is important to help manage risk. All securities are then carefully monitored for continued fundamental and technical attractiveness. When a portfolio is re-balanced, weaker securities are ejected and replaced with a more attractive alternative.

## About Stark Financial Advisers

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*Helping our Clients  
Balance Risk and  
Return*

WE ARE ON THE WEB

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Stark Financial Advisers is a registered investment adviser affiliated with R.M. Stark & Co., Inc., an SEC registered broker dealer. SFA seeks to achieve positive returns over a long-term investment horizon by creating and maintaining the optimum portfolio for each investor. We view the optimum portfolio as one having the highest potential return consistent with the risk tolerance and investment horizon of the owner.

We also understand the relationship between risk and return and seek to reduce risk through targeted asset allocation among numerous asset classes. Each asset class has separate and distinct characteristics, including returns and risk that can be measured over time. While all classes are cyclical, they often trend in different directions. Two portfolios, each having similar return prospects, may have substantially different short-term risk characteristics. Clearly, the lower risk portfolio would be the choice of most investors.

Of course, all investments contain risk and there is no guaranty of positive returns; losses can occur. For additional information and a complete performance history, please visit [www.starkadvisers.com](http://www.starkadvisers.com).

**Pursuant to Rule 204-3 of the Investment Advisers Act of 1940, we are required by the Securities and Exchange Commission to offer each of our clients a copy of our form ADV Part II that describes our firm and methods of operation. To receive a copy, please call our Managed Account Services Department at (800) 410-0704.**

## 4Q 2009 Reporting

Enclosed with this Commentary, Stark Financial clients have received their most recent Asset Allocation Report ("AAR"), 4Q2009 account values and performance, and comparative benchmark statistics.

In addition, a schedules of management fees paid during 2009 and realized gains and losses (taxable accounts) are enclosed. Management fees may be tax deductible. These schedules should be provide to your tax preparer.

In addition to these reports, the financial institution that is the custodian of you account may provide you with additional year-end docu-

ments such as a 1099. These documents may not be received prior to March and should also be provided to your tax preparer.

Should you have any questions, or if your financial objectives have changed, please give us a call.

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As always, we thank you for your confidence and business.

*"An  
investment in  
knowledge  
always pays  
the best  
interest"*

*Benjamin Franklin*

**Stark**   
Financial Advisers, Inc.