MorganStanley
SmithBarney

Dialogues » WEALTH STRATEGIES FOR DISCUSSION

Our definition of wealth management is understanding you better and gaining deeper insight into your and your family's needs, goals and values. By looking at your whole financial picture, We can help you develop sound investment strategies. Let's continue working together to optimize your portfolio potential.

THIRD QUARTER
2009

COURTESY OF
THE CASCO BAY GROUP

100 Middle Street
3rd Floor
Portland, ME 04101
Phone: 207-771-0852
Fax: 207-771-0870
Tollfree: 800-442-6722
thecascobaygroupsb@smithbarney.com
http://fc.smithbarney.com/cascobaygroup

DOUGLAS S. BEAN , CIMA®, CPWA℠
Senior Vice President-Wealth Management
Financial Advisor

BRIAN R. PRICHARD
Second Vice President-Wealth Management
Financial Planning Specialist
Financial Advisor

CHADWICK A. WEBER
Financial Advisor
Financial Planning Specialist

MARY R. GROSS
Financial Advisor
Financial Planning Associate

JONI H. VICKERY
Registered Associate
Financial Planning Associate

KRISTOFFER A. NOBLE
Consulting Group Analyst

Rethinking Risk in Retirement

Today, experts agree that longevity is the name of the game in retirement planning and investing, as life spans in the U.S. hit highs unprecedented in human history. According to AARP, actuaries now say that if a married couple is healthy at age 65, there's a 50 – 50 chance one of them may live to age 92.

Conventional wisdom says that as you near retirement, you should dial down portfolio risk and shift into bonds, known traditionally for their safety and dependability. But there's a consequence to that action: Tilting too far toward conservative holdings around age 65 may actually increase the risk of outliving your assets.

We're being challenged to adopt a new attitude toward asset allocation. The effect of this overall mix could be greater than, say, market timing or which company's stocks you choose—research published in 2000 by Yale finance professor Roger Ibbotson found that asset allocation could be responsible for up to 90% of a portfolio's returns over the long term.

Despite recent market volatility, long-term trends suggest that a sufficient allocation to equities is the best way, over the decades, to outpace inflation and keep up with the rising costs of living longer. Depending on your life expectancy, tilting the balance toward conservative bonds and cash equivalents may need to begin closer to age 75 than age 50.

We can help you determine how the assets in your portfolio should be allocated to help meet your specific needs and goals. How you deploy your funds is one of the most important decisions in your financial life—and quite possibly, one of the key factors to having your money last as long as you need it to. ■

Diversification does not ensure against loss. Bonds are affected by a number of risks, including fluctuations in interest rates, credit risk and prepayment risk. In general, as prevailing interest rates rise, fixed income securities prices will fall. Bonds face credit risk if a decline in an issuer's credit rating, or creditworthiness, causes a bond's price to decline. High yield bonds are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues. Finally, bonds can be subject to prepayment risk. When interest rates fall, an issuer may choose to borrow money at a lower interest rate, while paying off its previously issued bonds. As a consequence, underlying bonds will lose the interest payments from the investment and will be forced to reinvest in a market where prevailing interest rates are lower than when the initial investment was made.

Morgan Stanley Smith Barney LLC. Member SIPC.

134356

Teaching College Kids the Basics About Money

The college years are a great time to teach kids how to be responsible for—and about—their money. For some students, this is when they begin to figure out what things cost and how much money they need to live.

They also can learn valuable lessons in budgeting, cost cutting, debt management and protecting themselves against identity theft. If all goes well, your children should graduate with many of the tools needed to manage resources responsibly when out on their own. Here are some ideas to get you started:

What They Need. Equipping a college dorm room can be a big job; meeting the banking needs of the average college student is not. Students need a **checking account** with a **debit card.** Be sure your children are not going to incur any ATM fees. If the college is in a small town, that may mean opening a local account. In a big city, be sure the bank has a branch near campus. Whatever the arrangement, your children should know which ATM machines to use. If you have an account on which ATM fees are waived, you may be able to set up a linked account for your children. If the account is with a different bank, you can generally still link your children's accounts to yours so you can transfer money electronically.

Much has been written about whether or not to have a **credit card** at college. The House Financial Services Committee on Financial Institutions and Consumer Credit held hearings last summer to address the aggressive marketing of credit cards to students. A survey published by student-loan provider Nellie Mae in 2005 (the most recent data available) showed that the average outstanding balance on undergraduate credit cards was $2,169. The same study reported that 56% of students carry four or more cards by the time they graduate. Since many students leave school with student loans to pay off, parents should think carefully about the possibility that arming a student with a credit card could add to the debt load in the long term.

It's best to start with common sense: Unless a student is earning income, paying a monthly credit card bill is an impossibility. Remind your children that they don't get a good credit rating just by having a credit card—they have to pay the bills on time. At the very least, consider waiting a year until your student has built a good track record of managing cash and learning to put money aside in savings before signing up for a credit card.

We can share some ideas about what might be a good choice for a checking account and what type of credit card will work when the time comes.

What They Spend. Many colleges have estimates of annual expenses on their Web sites. These tend to fall in the $1,500 to $2,000 range and may or may not be useful depending on how typical your children's spending habits are, so be prepared to do a little tinkering to get to the right number. The goal is to arrive at a fixed monthly amount that you will put in their accounts, leaving your children the responsibility of managing finances so they do not run out of money before the end of the month.

Doing some research to arrive at a realistic estimate of expenses is worthwhile. But remember that the decision ultimately hinges on your own finances: What monthly amount is both appropriate and affordable for *you*? If you don't start here, you're off on the wrong foot. You are trying to teach your children the logic of financial planning. In the real world, we all have to start with a number—usually a salary—and work back from that to figure out how much we can spend on rent, food and other necessities.

Once you have your number, encourage your children to draft a personal budget. Make sure they understand what is already paid for (how many of their meals

"By the time they graduate, you want them to have a sense of what the key components of living expenses really are.

are covered, for example). For the first few months, get them to keep track of the money they spend on going out with friends, things for their room, clothing and so on. As they get some experience with the process, give them more money so that they can take more responsibility for their finances—let them begin to pay the monthly bills such as those for student loans, rent, utilities, meal plans and even travel expenses. By the time they graduate, you want them to have a sense of what the key components of living expenses really are.

There are many budgeting tools available online—you may already use one yourself that you want to recommend. Since most kids' finances are very simple, using a program is really more for practice at this stage.

Cost Control. Encourage your children to take advantage of all the ways to save money at college. Student discounts are available on everything from travel to clothing. There is usually a place on campus to buy and resell used books. Be sure your children understand all the costs associated with having a car if this is something they are planning on.

Identity Theft. Kids spend a great deal of time communicating via the Web and it may be hard for them to anticipate how this free flow of information could be detrimental. Educate them about what identity theft is and explain how they can protect themselves against it.

Here is a short list of information from Nellie Mae that we should only share when we know exactly what it is being used for and by whom:

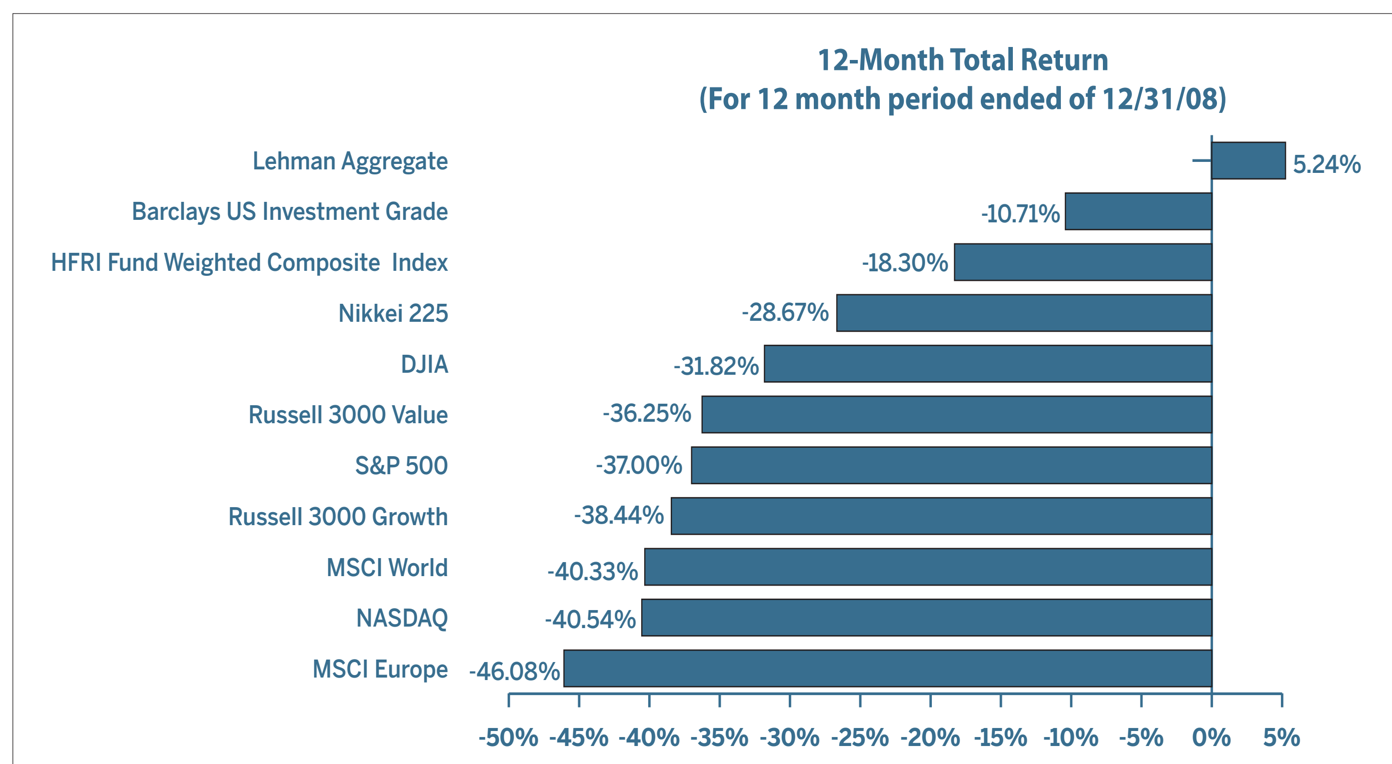
- Social Security number (do not carry your Social Security card in your wallet)
- Passwords and PINs for debit cards, phone cards, computers
- Credit card numbers
- Current and former addresses
- Birth date
- Mother's maiden name and birth date

Conversations about finance with teenagers are not always easy. Learning how much things cost can be quite an eye-opener—many kids just haven't thought much about money matters. But investing time in getting them on the right track will pay significant dividends down the road. You never know: One day they may even thank you for the lessons learned. ■

Reaffirming the Relevance of Alternative Investments in a Well-Diversified Portfolio

While it is no secret that 2008 was the worst year on record for hedge funds, it is, however, a fact that is reported largely out of context.[1]

If we examine the broad markets as a whole, hedge funds did not have that bad of a year, relatively speaking (as illustrated in the chart below).

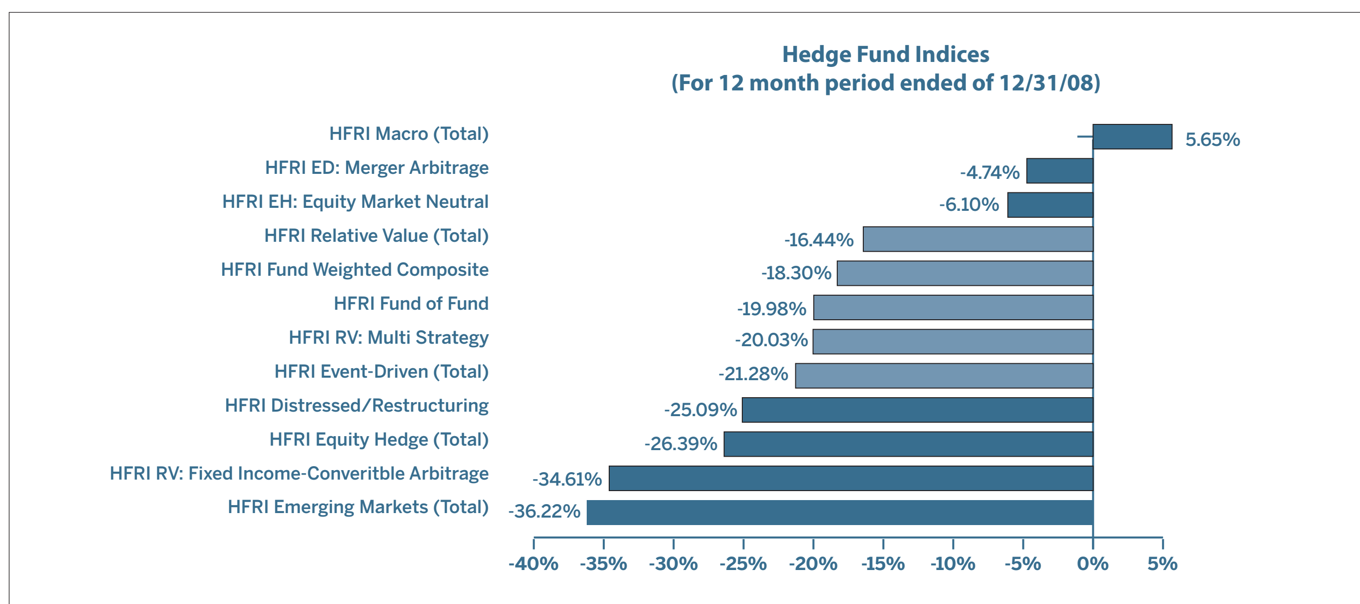


Source: Citi, HFR. Indices are presented merely to show general trends in the markets for the period and are not intended to imply that a particular fund's portfolio is benchmarked to the indices either in composition or level of risk. The indices are unmanaged, not investable, have no expenses and reflect reinvestment of dividends and distributions. Index data is provided for comparative purposes only. A variety of factors may cause an index to be an inaccurate benchmark for a particular fund and the index does not necessarily reflect the actual investment strategy of a particular fund. **Past performance is not indicative of future results.** See final page for index definitions.

[1]Hedge Fund Research.

Investments in alternative investment products are generally limited to investors that qualify as "Accredited Investors" under the Securities Act of 1933, as amended, and/or "Qualified Purchasers" under the Investment Company Act of 1940, as amended, depending on the terms of the alternative investment product. Accordingly, prior to making any investment in an alternative investment product, an investor will need to satisfy the relevant suitability qualifications related to that product. The information contained herein is directed exclusively to those investors that are "Accredited Investors" and/or "Qualified Purchasers."

Furthermore, there was a wide dispersion of returns among hedge fund strategies. As suggested in the chart below, 2008 saw returns range from -36.22% (Emerging Markets Strategy) to 5.65% (Macro Strategy). What's more, all of the hedge fund strategies depicted in the chart below for the year ending December 31, 2008 not only beat the S&P 500, but also beat MSCI Europe, Nasdaq, MSCI World, Russell 3000 Growth and Russell 3000 Value. (Past performance is no guarantee of future performance).



Source: HFR. Indices are presented merely to show general trends in the markets for the period and are not intended to imply that a particular Fund's portfolio is benchmarked to the indices either in composition or level of risk. The indices are unmanaged, not investable, have no expenses and reflect reinvestment of dividends and distributions. Index data is provided for comparative purposes only. A variety of factors may cause an index to be an inaccurate benchmark for a particular fund and the index does not necessarily reflect the actual investment strategy of a particular fund. **Past performance is not indicative of future results.** See final page for index definitions.

Although hedge funds typically have lower correlations to the broad markets, this year was an aberration of sorts as we witnessed higher correlations between the two.[2] There are a few reasons for this:

- A general loss of confidence in the economy among investors
- Extreme deleveraging across global markets
- Curbs on short selling which contributed to hedge fund losses
- Massive redemptions in hedge funds

Perhaps most significant has been the issue of redemptions. Hedge funds have faced (and continue to face) an element of flow risk, which is when a manager experiences significant redemptions mostly due to industry-wide issues or a specific category of investors, rather than due to issues related to the manager itself.[3] In fact, Hedge Fund Research reported that in the fourth quarter of 2008 alone, investors withdrew a record $152 billion in capital.

That being said, hedge fund managers still have an advantage over traditional managers considering they have more flexibility in how they can invest. For instance, they may use strategies such as short selling or derivatives to hedge risk and maximize return. This flexibility is primarily why hedge funds, as represented by the HFRI Fund Weighted Composite Index managed to outperform the broad equity markets, as represented by the S&P 500 Index, in 2008.

FUTURE OPPORTUNITIES

Many financial experts predict that the future of alternative investments is going to be one full of major changes as well as opportunities. Some of the changes expected in the hedge fund industry are as follows:

- Tighter regulation
- Greater management controls

» Country-specific hedge fund regulation

» Leverage will be difficult to attain

» Size of the market will shrink

» Lower fees due to competition within the industry

In terms of current opportunities, many managers in the hedge fund space are focusing on strategies such as distressed investments. We currently offer a handful of distressed hedge funds on our platform, most of which aim to capitalize on the real estate and financial turmoil that has ensued in the market.

At the end of the day, the largest and "best-in-class" hedge funds will most likely be the ones to survive. Future opportunity in the hedge fund world may once again flourish, albeit in a more concentrated and competitive universe. ■

[2] *FA* magazine, 2/29/08.

[3] AllAboutAlpha.com 1/4/09.

The Lehman Aggregate is an index of U.S. domestic, taxable and dollar-denominated securities. The index covers the U.S. investment-grade fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis. The Barclays U.S. Investment Grade Index covers all publicly issued, fixed-rate, nonconvertible, investment-grade corporate debt. Issues are rated at least Baa by Moody's Investors Service or BBB by Standard & Poor's, if unrated by Moody's. Collateralized Mortgage Obligations (CMOs) are not included. Total return comprises price appreciation/depreciation and income as a percentage of the original investment. Indexes are rebalanced monthly by market capitalization. The HFRI Fund Weighted Composite Index accounts for over 1,600 funds listed on the internal HFR Database. The Nikkei 225 is an index composed of 225 leading stocks on the Tokyo Stock Exchange. The DJIA is this most widely used indicator of the overall condition of the stock market, a price-weighted average of 30 actively traded blue chip stocks, primarily industrials. The Russell 3000 Value Index measures the performance of the broad value segment of the U.S. equity universe. It includes those Russell 3000 companies with lower price-to-book ratios and lower forecasted growth values. The S&P 500 is a capitalization-weighted index of 500 stocks trading in U.S. equity markets. Performance is calculated on a total return basis. The Russell 3000 Growth Index measures the performance of the broad growth segment of the U.S. equity universe. It includes those Russell 3000 companies with higher price-to-book ratios and higher forecasted growth values. The MSCI World is an index consisting of approximately 1,500 stocks in 23 countries globally and representing a significant portion of the total market capitalization in those countries. The Nasdaq stands for National Association of Securities Dealers automatic quotation market which is a mostly electronic market of stocks in the United States. The MSCI Europe is the Morgan Stanley Capital International Europe Index, a free float-adjusted market capitalization index that is designed to measure developed market equity performance in Europe.

The Hedge Fund Research, Inc.'s Performance Indexes (HFRI) are equally weighted performance summaries of over 1,600 hedge funds tracked by Hedge Fund Research, Inc. These indexes incorporate funds that have ceased to exist and all fund performance is reweighted each month to incorporate new funds and to eliminate defunct funds. The HFRI Monthly Indices are utilized by numerous hedge fund managers as a benchmark for their own hedge funds. The HFRI are broken down into 37 different categories by strategy including Fund of Funds. While the HFRI Indices are frequently used, they have limitations (some of which are typical of other widely used indices). These limitations include survivorship bias (the returns of the indices may not be representative of all the hedge funds in the universe because of the tendency of lower-performing funds to leave the index); heterogeneity (not all hedge funds are alike or comparable to one another, and the index may not accurately reflect the performance of a described style); and limited data (many hedge funds do not report to indices, and the index may omit funds, the inclusion of which might significantly affect the performance shown. The HFRI Indices are based on information self-reported by hedge fund managers that decide on their own, at any time, whether or not they want to provide, or continue to provide, information to HFR Asset Management, LLC. Results for funds that go out of business are included in the index until the date that they cease operations. Therefore, these indices may not be complete or accurate representations of the hedge fund universe, and may be biased in several ways.

Distressed strategies invest in obligations of troubled companies, which are often already in bankruptcy. Advisors attempt to identify specific securities or other obligations that are trading at discounts to their long-term realizable or intrinsic value. These investments can result in substantial or total loss due to business and financial risks. An investment in distressed securities may involve a high degree of risk and should be undertaken only by sophisticated investors capable of evaluating, and bearing, such risk. This material does not purport to be a complete disclosure of all risks that may be relevant to any particular investor's decision to invest in these types of funds. Risks of distressed securities may include concentration of investments, illiquid portfolio investments, leverage, defaulted securities and bank debt transactions, in addition to general investment risk. Past performance is no guarantee of future results. Real results may vary.

An investment in a fund is speculative, not suitable for all clients, and intended for experienced and sophisticated investors who are willing to bear the high economic risks of the investment, which can include: loss of all or a substantial portion of the capital invested due to speculative investment practices; lack of liquidity in that there may be no secondary market for the funds and none expected to develop; volatility of returns; restrictions on transferring interests in the funds; absence of information regarding valuations and pricing; delays in tax reporting; less regulation and higher fees than mutual funds; and advisor risk. No guarantee or representation is given that the funds will achieve their investment objective.

All expressions of opinion herein are subject to change without notice and are not intended to be a guarantee of future events. This material is for information only and does not constitute a solicitation to buy or sell securities. Opinions expressed herein may differ from the opinions expressed by other businesses or affiliates of Citigroup, and are not intended to be a forecast of future events, a guarantee of future results or investment advice, and are subject to change based on market and other conditions. In any case, past performance is no guarantee of future results, and future results may not meet expectations due to a variety of economic, market and other factors. Further, although information in this material has been obtained from sources believed to be reliable, Citigroup and its affiliates do not guarantee its accuracy or completeness and accept no liability for any direct or consequential losses arising from its use. Investments mentioned in this material may not be suitable for all investors, and this material does not purport to be a complete disclosure of all risks that may be relevant to any particular investor's decision to make investments of the type mentioned herein. Before making any investment, each investor must obtain the investment offering materials, which include a description of the risks, fees and expenses and the performance history, if any, which may be considered in connection with making an investment decision. Each investor should carefully view the risks associated with the investment and make a determination based upon the investor's own particular circumstances, that the investment is consistent with the investor's investment objectives.

Recognizing How You and Your Business Work Together

If you are a business owner, chances are that some of your biggest concerns relate to business costs. In fact, research released in June 2008 by the National Federation of Independent Business reported that half of the top ten problems that worry small-business owners are in the "costs" category, be it the cost of utilities, supplies, health care or inflation.

If these concerns sound familiar, you already know how critical a role cash flow and a sound cash-management strategy play in your business. But is your overall strategic approach as efficient and beneficial as it could be? If you haven't factored your personal financial life into your business planning, the answer may be "no."

Think for a moment about the many parts of your financial life, both business and personal—from your retirement accounts to the daily cash needs of your business; from vendor payments to tuition payments for your kids; from the mortgage on your lake house to the financing you need to buy out your biggest competitor. By using a "sum-of-parts" perspective, you can see how decisions made in one piece of your wealth puzzle can improve—or diminish—a different piece.

For example, say you wanted to build a new headquarters for your business. To do so, you may secure financing from your local bank—it's a basic approach. The bank, however, won't necessarily know about your ten-year plan to retire and sell the business, and certainly is not focusing on how attractive those financing terms might be to potential buyers down the road.

We, on the other hand, can work with you to help find structures that carefully consider the big picture for both you and your business. This process begins with an assessment of your company's assets and liabilities, cash flow, short-term objectives and long-term plan—and ends with a better understanding of you and what you want to achieve, both with the business and without.

BUSINESS LENDING

When you started out, you may have borrowed to pay the rent, to cover some meals and to make sure the lights stayed on—and that was just for the office. Today, rather than a means for survival, borrowing is a potential growth tool for your business, one that allows you to expand into new markets, upgrade facilities and in many cases, just keep things humming.

Working with us, you have access to Citi's global financial network and knowledgeable business bankers, who can provide the right tools and the proper scope to help your business take advantage of just about any opportunity. Whether it's upgrading your equipment, financing the construction of new office space or just replenishing inventory, we and Citi's professionals can help you—all within the context of your projected financial plan.

CASH MANAGEMENT

As your business has evolved, so has its financial needs. What was once an offshoot of your personal checking account may now be a complicated web of credit facilities, lease agreements, controlled disbursement accounts and about ten other things listed on your various bank statements.

We, however, can help you see not only how these products connect with your bank statement, but also how they connect with you and your business. We understand that cash flow is your lifeblood, that you rely on timely payments from your customers in order to sustain the business—and how, for example, something as simple as electronic collections can improve not only that cash flow, but perhaps also relations with your accounting department.

And because we can connect you with banking professionals throughout Citi who can help you handle the day-to-day management of your cash operations, you'll be able to focus on more important things, like launching that new product or anticipating the market's reaction to your next big idea. ■

When used wisely, borrowing can be beneficial to your total wealth management. All commercial loans and lines are made by Citibank, N.A., equal credit opportunity lender. All credit products are subject to satisfaction of Citibank's underwriting guidelines and credit approval. Deposit products are offered through Citibank, N.A. Member FDIC.

Did You Know?

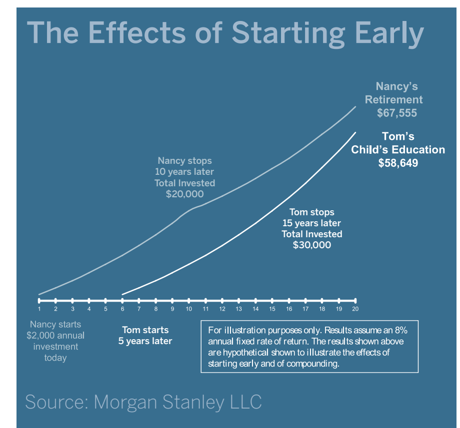
The Benefits of Starting Early

Thomas Jefferson once said, "Never put off till tomorrow what you can do today." A familiar phrase that no doubt has rolled off the tongues of many a parent who implored an unwilling child to mow the grass, take out the trash or clean a room.

But like the procrastinating child who waits until the last minute, many adults fail to heed their own words. They put off until tomorrow the investment plan they should begin today.

There's no better time than the present to begin planning for the future. Your child's education or your retirement may seem a long way off, but don't be fooled. A delay today can impact what you may earn tomorrow. Let's take a look at two hypothetical investors, Nancy and Tom. Nancy is a working mother who plans to retire in 20 years. She hopes to grow her retirement nest egg to a level that will support her in retirement. Tom, meanwhile, just got married. He and his wife anticipate starting a family and would like to start investing in a college fund with a 20-year time horizon. Nancy starts her investment program today with a $2,000 initial investment. She invests the same amount each year for the next ten years for a total investment of $20,000. Tom, on the other hand, procrastinates. He puts off his initial $2,000 investment for five years, then tries to make up for lost time by investing $2,000 each year for the remaining 15 years. His total investment reaches $30,000. Who do you think fared better at the end of the 20-year period? Nancy, who invested less money? Or Tom, who invested more?

The answer may surprise you. Assuming that both earned an 8% annualized rate of return, Nancy's $20,000 grew to $67,555 while Tom's $30,000 grew to $58,649. Remember, this chart is for illustrative purposes only and is not meant to be a recommendation. And in the real world, unlike in our hypothetical model, taxes, market fluctuations and the costs of investing can alter investment results. However, in this case, the benefits of starting early are evident. ■



© 2009 Morgan Stanley Smith Barney LLC and its affiliates do not provide tax or legal advice. To the extent that this material or any attachment concerns tax matters, it is not intended to be used and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed by law. Any such taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.