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4th Quarter Newsletter

Planning for Higher Tax Rates

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A number of factors look to make higher taxes inevitable for many Americans. There's the incredible cost of the credit crisis bailout and all its peripheral costs. On January 1, 2011, the entire 2001 EGTRRA Act will sunset. Capital gains, income tax, the estate, gift, and generation-skipping tax rates will all automatically reset to their higher pre-EGTRRA levels unless Congress acts before then. Then there is the continuing impact of the Alternative Minimum Tax on more and more middle class taxpayers. The new Administration's desired program expansions and goals also come with considerable costs that will need to be met.

All of which brings up the need to structure your investments and assets to minimize your tax bite and optimize the earning potential of your investments. Below are some ideas you might want to discuss with your tax and financial advisers and put in place.

1. Optimize tax-advantaged accounts.

To reduce your taxable income, take advantage of any retirement plan contributions you can make to defer taxes. The table below shows employee contribution limits for 2008 and 2009, including catch-up provisions for individuals over 50. There are income restrictions to be eligible for an IRA or Roth IRA, so check with your financial advisor prior to making a contribution.

Type of Retirement Plan	Maximum Annual Contributions			
	2008		2009	
	Under Age 50	50 and Older	Under Age 50	50 and Older
Individual Retirement Plans*				
Traditional and Roth IRA	\$5,000	\$6,000	\$5,000	\$6,000
Employer-Sponsored Retirement Plans				
401(k), Roth 401(k), 403(b), 457 and SARSEP Plans	\$15,500	\$20,500	\$16,500	\$22,000
Small Business or Self-Employed Retirement Plans				
Self-Employed 401k (a.k.a., Solo-401k, Individual 401k, Roth 401k)	100% of compensation up to \$15,500	100% of compensation up to \$20,500	100% of compensation up to \$16,500	100% of compensation up to \$22,000
SIMPLE (Savings Incentive Match Plan for Employees) IRA or 401(k)	\$10,500	\$13,000	\$11,500	\$14,000
Coverdell Education Savings Account*				
Per beneficiary under age 18	\$2,000		\$2,000	
Health Savings Account				
Individual	Between 55-64		Between 55-64	
Family	\$2,900	\$3,800	\$3,000	\$3,900
	\$5,800		\$5,950	

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2. Roll over traditional IRA accounts into a Roth IRA.

With many IRA accounts below prior year values, this may be the time to roll those accounts into a Roth IRA. Withdrawals from Roth IRAs are exempt from federal income taxes, however, contributions are not deductible and come from after-tax income. As a result, you will need to pay income taxes on amounts transferred from a traditional IRA to a Roth. There are income limitations for Roth conversions, so check before you convert. Barring new legislation, these limitations are set to expire in 2010, when anyone can convert to a Roth without regard to income.

3. Avoid capital gains distributions.

Even when mutual funds decline in net asset value, you can still get caught with capital gains if the funds sell appreciated assets to meet withdrawal demand. To avoid the capital gains issue, place mutual fund investments in tax-advantaged accounts, or sell funds that have lost value prior to distributions for the year, typically in December. Remember you cannot buy back into the same fund or a fund with the same investment directive for 30 days without running afoul of IRS rules. This may also be the time to look at Exchange Traded Funds, which avoid distribution requirements.

4. Harvest your tax losses, but avoid wash sales.

When you realize capital losses, you can offset any capital gains with those losses. If you have more losses than gains, the IRS allows use up to \$3,000 of net investment losses to offset income in the current year and carry over additional losses to offset future capital gains indefinitely. Just be aware that if you buy substantially identical replacement investments within 30 days after the sale — or within 30 days before the sale — you can't deduct your loss under the wash sale rule.

This wash sale rule can apply even if you don't acquire stock. If you enter into a contract or option to acquire stock, that's enough to make the wash sale rule apply, as can selling options at a loss. The wash sale rule has three consequences: (1) You are not allowed to claim the loss on your sale. (2) Your disallowed loss is added to

the basis of the replacement stock. (3) Your holding period for the replacement stock includes the holding period of the stock you sold.

5. Consider tax exempt bonds.

Income from taxable bonds and bond funds is taxed at ordinary income-tax rates (as high as 35% now). This can make tax-exempt municipal bonds or a municipal-bond fund a better investment for after-tax yields. To the extent that you own taxable bonds, particularly high-yield bonds that produce income, consider holding them in tax-sheltered retirement accounts.

6. Use alternative investments to avoid losses in positions with large capital gains.

If you are concerned that an investment with substantial gains could decline in value and you want to lock in profits, consider the use of alternative investments such as inverse funds, contra-Exchange Traded Funds (ETFs), and options that allow you to hedge your gains to avoid liquidating a position. Be careful of selling out of closed funds, where you might not be able to reinvest later.

7. Consider AMT liabilities before taking gains.

The alternative minimum tax (AMT) is impacting more and more middle-class and upper-middle-class taxpayers. Taking major gains, exercising stock options and simply realizing more income than prior years may entangle you in the AMT.

8. Get credit for your generosity.

If you itemize your deductions, you can deduct charitable contributions. Save receipts and canceled checks as proof. Strategic giving can lower your income and allow your money to go to causes you support rather than taxes.

The preceding ideas are for general information purposes only and should not be considered tax or accounting advice. Every individual's situation differs. Talk to your financial or tax adviser about ways to reduce your taxable income before implementing any of these suggestions.

The major indexes in the 4th quarter of 2008 showed amazing resiliency in the face of very poor economic data. Is this a welcome sign of calm, or the calm before the storm? Efficient market theorists believe that at any given time, the market is fairly priced, having all information, known and unknown, good and bad, "priced into the market". We are not convinced. And since we are not students in a classroom debating its merits, we must listen carefully to congress when after passing the 700 billion dollar Troubled Assets Relief Program ("TARP") and rescuing AIG among others, many congressional leaders still warn that this step does not solve all our problems. Additionally, President-Elect Barack Obama was recently quoted as saying "it's going to get worse before it gets better. Given these events and opinions, how may anyone reasonably conclude that this broad and deep level of uncertainty is "priced in?" We have our doubts.

Moreover, for those who think we have seen the worst, the alarming increase of consumer defaults in both auto loans and credit cards seems to suggest that this recession is not moderating, but picking up steam. We find ourselves in tough times and far too many Americans are now faced with the reality of having to choose between paying their mortgage, car loan, credit card or student loan, all the while making sure that basic necessities are met. Should these conditions persist, our nation may need to endure a second wave of mortgage defaults, and this time it may not be relegated only to subprime credit borrowers. How is all of that priced into the market?

Now everyone knew at least some of this negative news at this time last year, but we held onto the hope that our strong labor and employment numbers would pull us through; not anymore. The United States economy shed 570,000 jobs in the month of November alone, marking the largest monthly job loss since 1974! Today, we have seen our current job losses dramatically surpass those of the last three recessions. In the recessions of both 2001 and 1990-91, job losses peaked at 325,000 and 306,000 respectively, reaching those lofty levels in the last month of those recessions. And in 1981-82, peak job losses reached 343,000, four months before that recession ended.* So, what does all of this mean?

A review of these numbers suggests that a bottom in the jobs market often indicates a near bottom of a recession. Trouble is: we will not know what the peak job losses are of this recession until after we pull out of it, looking at the numbers in the rear-view mirror, and while 570,000 translates into a 40 percent increase over the 1981-82 worst levels, we cannot yet be sure we have seen the worst. Further, as if the unemployment picture is not sobering enough, the winds from this economic storm continue to batter residential real estate, wiping-out more than two trillion in market value, while flipping 1 in 6 home owners upside-down, who now owe more on their house than it is worth (bankruptcylawnetwork.com). Consequently, even at the lowest mortgage interest rates in history, refinancing is impossible for those upside-down, and very difficult for others who may have lost their job or are getting squeezed by the credit crunch. For many, the American dream of homeownership has turned into a Nightmare on Main Street.

AIG, Bear Stearns, Citigroup, Countrywide, Fannie Mae and Freddie Mac, Lehman Brothers, Merrill Lynch, Wachovia, Washington Mutual, Chrysler, Ford and GM, all have either collapsed, been bailed out, or merged to stave off their demise; mark 2008 down in your journals as a truly historically bad year. Add to all of this the consumer whose confidence is the lowest on record, contributing to a historic drop in consumer spending over the holiday season, and the ripple effect of this recession can be seen and felt in nearly every sector of our economy. These facts cast a rather ominous cloud over the outlook for this quarter's corporate earnings, and generally, earnings are what typically drive the stock market. We have no crystal ball, but it is fairly safe to say that until we see some mitigation in unemployment and the precipitous decline in home values, and some stabilization in corporate earnings, volatility will continue to be the dominate theme in both the equity and bond markets.

Fourth Quarter 2008 Securities Markets Commentary Continued

Several pundits are now proclaiming that we have seen the bottom of the market, since we are up significantly off of the market lows recorded on November 20th. Does this mean now is the time to invest? Perhaps, but we believe prudence dictates a more cautious and measured approach. What if this move off of the bottom is only a *bear market rally*? A bear market rally is essentially just an interruption (temporary increase in prices) in the overall downward trend of a bear market. Just as we see interruptions (temporary price declines) during bull market cycles, we also see upward movement in bear markets. When this occurs, all too often investors and traders are afraid of missing out, so they react by activating cash reserves, tantalized into thinking that the market has bottomed, only to have the market rollover again and continue the primary bear market trend.

Statistically, a bear market rally may be defined as an increase of 10% to 20%. The DJIA saw an approximate 20.9% increase from the market low of November 20th to December 9th after Congress conducted hearings on yet another “bailout,” this time for the beleaguered “big three” auto manufactures. (Subsequently, the Senate rejected the bailout, although President Bush granted a temporary bridge loan from TARP funds to hold them over until the next administration.) The Dow’s move off the bottom was swift and significant, but when looking more closely at the math, it is a little less remarkable. One might expect a positive 20.9% move in the Dow to translate into strong double digit appreciation in one’s existing equity holdings; however, the recent move netted only a 10.71% gain to many of the indexes, when viewed on an annualized basis. How is this possible? Consider the S&P 500 Index: it rang in the 2008 New Year at 1468.36, and on November 20th, it closed at 752.44, posting a then year to date negative return of 48.76%. From that low, it gained 20.9% in only 19 days, to close at 909.70 on December 9th. While this was a 20.9% move off the bottom, it accounted for only a 10.71% overall improvement in the index, ameliorating its YTD negative return from 48.76 % to 38.05%. The following chart illustrates this observation:

S&P 500 (No Dividend Included)

December 31 st 2007 Index Price Level	1468.36
November 20 th 2008 Index Price Level	752.44
December 9 th 2008 Index Price Level	909.70
Year to Date Return as of November 20 th	-48.76%
Move from November 20 th to December 9 th	20.90%
Year to Date Return as of December 9 th	-38.05%
Percent Move on Yearly Basis Nov. 20 th to Dec. 9 th	10.71%

Whether driven by fear, greed, or something in between, bear market rallies can confuse and confound even the most seasoned investors. Succumbing to the fear of not getting in early enough during a market recovery or the greed of missing out on what historically have been the biggest gains (off of the bottom), many try to time the market and buy on impulse rather than sticking to a disciplined strategy. We resist that temptation.

And lest you think all the news out there is bad, there are moderating and positive signs in the economy, such as the free-fall of oil and the return to reasonable gasoline prices, and a possible pent-up housing demand due to the events we described earlier: dropping prices, low mortgage rates, and a significant number of displaced folks from foreclosures, along with a growing population; they will eventually have to live somewhere. Nevertheless, the market needs to prove to us that it is worthy of our clients’ hard earned investment capital. This will occur when we see greater stability in the general day to day functioning of the credit and stock markets, and improvement in such fundamentals as corporate

Fourth Quarter 2008 Securities Markets Commentary Continued

earnings, unemployment, and lending practices. Some would argue that by the time we see all of that, it will be too late to invest. We tend to agree, which is why we employ investment modeling technology that detects such events in their early stages. We do not rely on national polling data and governmental releases inasmuch as they reflect more opinion than fact. Instead, we focus on a more objective criterion: the price of the underlying securities in which we may invest. In order for the markets to return to more normal patterns, we must see some price stability. As that occurs, it will present opportunities to get back into the market with reasonable risk to the portfolio. Of course, our technology also supplies tools for stop/loss events to cushion the blow should the markets again turn south.

In review of the Fourth Quarter activity, the S&P 500 Total Return Index, which is inclusive of dividends, experienced a negative -22.56% for the quarter and ended at negative -37.00% for the year. The Dow Jones Industrial Average posted a negative -19.17% for the quarter and recorded a negative -31.93% for the year. The technology focused NASDAQ had negative -24.61% for the quarter and shows a negative -40.54% for the 2008 year, while the Lehman Aggregate Bond Index, representative of many different bond investments, experienced a positive 7.38% return for the quarter and pulled into positive territory for the year with a return of 5.81% ending 12/31/2008.

All in all, we would rather be invested in securities than holding cash; it is the best way we know of to outpace inflation and help clients maintain their standard of living through the growth of their portfolios. However, there are certainly times when preserving portfolios by holding cash takes center stage, and the market's performance in 2008 has been one of the strongest confirmations in history that cash and money markets are not only viable alternative investments, but they can outperform the market while preserving portfolios to invest another day.

Disclaimers

- * <http://www.speroforum.com/site/article.asp?id=17005>
- * The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.
- * The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.
- * The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.
- * Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.
- * Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.
- * Consult your financial professional before making any investment decision.
- * You cannot invest directly in an index.
- * Past Performance does not guarantee future results
- * Fourth Quarter 2008 Securities Market Commentary courtesy of Heath Smargiasso.

Is It Over Yet?

Has the bear market come to an end? You'll find a lot of opinions and talking heads with answers based on prior market declines and recessions, but before you take those answers for fact, consider that those opinions are often based on scanty data and what "has been." The only way we will know for sure is hindsight.

You can't count on historical averages applying to today's situation.

This market decline is different from those of the '70s, '80s and even the early 2000s. The bubbles that brought it on in the housing and credit markets did not involve just investors or corporations but rather a wide swath of the population at all income levels. Unwinding the excesses will take years in the natural course of life. Government intervention to avoid widespread pain could prolong the recovery even longer.

With that said, one indicator that may offer the best clue of the direction of the stock market is the 200-day moving average.

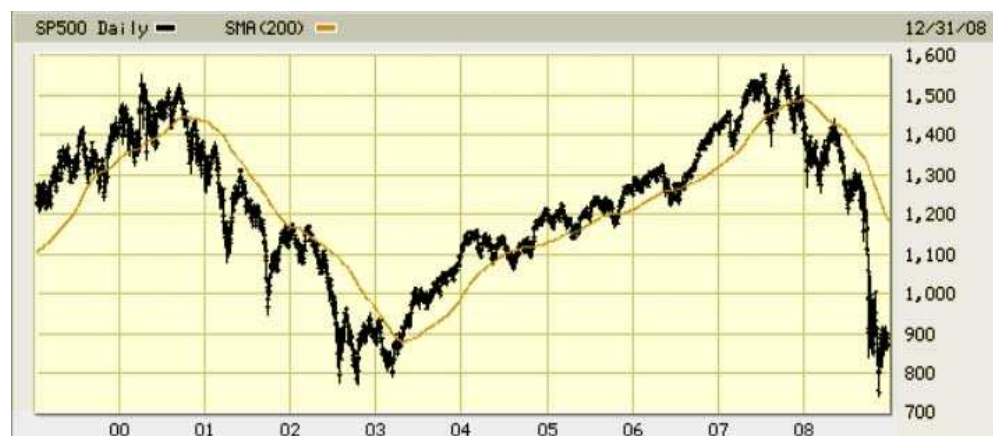
The 200-day moving average is typically considered to be the dividing line between a stock or a market that is technically healthy and one that is not. It is based on the current trend of the market and does not attempt to interpret the market based on prior situations.

A simple moving average is calculated by adding the last 200 days closing prices and dividing by 200. Each day a new value is added, the oldest is dropped, moving it along the time scale. An exponential moving average is much the same, but gives greater weight to later values.

As long as prices are above the 200-day moving average, the market is said to be in an uptrend. When values fall below the moving average, a downtrend is underway. Because a moving average lags the actual market, the turnaround in market direction always happens before the moving average signals confirmation.

The indicator is not perfect. In the chart below of the S&P 500 and its 200-day moving average over the last 10 years, you can see where brief whipsaws occurred when the market appeared to be changing direction only to revert to its earlier trend.

When the gap between the moving average and actual market values is at the widest, many analysts believe a change in market direction is indicated. But as the plot for the S&P 500 through December 31 shows, there can be no assurance as to how long that change might last.



Keep in mind that past performance is no guarantee of future market performance. Markets have a way of bumbling investors at all levels, as 2008 has shown. The S&P 500 is an index and cannot be invested in directly.



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Protecting Your Assets

Bernard Madoff's alleged Ponzi scheme is notable primarily in the size of the fraud - \$50 billion – and its length – in excess of 20 years. But the story itself is all too familiar. Like many con artists, Madoff used a stellar reputation and connections in the financial and political arenas to avoid questions on how he managed to achieve profits when others faltered.

Whether Madoff's investment management services began as a legitimate business or as a fraud, we don't know. What we do know are precautions that could have kept his investors from losing so much:

Always have an independent, credible verification of account values and performance.

While we believe the vast majority of money managers are honest, you need to have a means of verifying performance.

The better the performance, and the less you understand how it was achieved, the greater your caution should be. The financial markets have a way of humbling everyone at one time or another. Problems arise when the manager is unwilling to admit to failing and turns instead to great risks in hope of recovering or even fraud to cover up losses.

Diversification is essential. The investors hurt the most are the ones who trusted Madoff with virtually all of their investment assets. But, fraud isn't the only reason for diversification. All investment approaches have periods of underperformance. Diversification by strategy, asset class and individual investments gives you at least a measure of assurance that you won't lose everything to a bad decision, whether yours or the manager's.

Make Dollar Cost Averaging Work for You

Ideally, you are continuing to make contributions to your retirement plans and setting aside money to achieve your long-term goals, whether an education for your children, a new business venture, vacation home, or just the ability to relax in the sun. The problem is, what do you do with those assets when the market is falling?

The common advice is to keep investing in equities or your favorite mutual funds in a dollar cost averaging approach regardless of the market's direction. We beg to differ. There is nothing wrong with cash as an asset class if your alternatives are falling in value.

Declining markets are not the time to stop saving, but they are the time to pull back on new investments. Your goal should be to invest only in assets that are increasing in value. And, you should have an exit plan if they stop increasing in value, particularly if they start declining. Buy low and sell high only works if you sell when values are high so that you have the funds to buy when values are low.

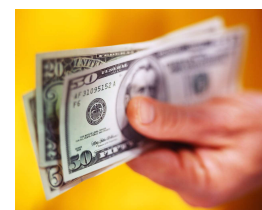
Capital preservation is the most important aspect of successful investing. We don't know when the market is going to stop gaining value or when it will stop falling. What we do know is that markets move in cycles. They become overbought, fall below realistic values and then struggle back up.

Selling is typically the hardest part of investing. You want to let your winners run. As long as a position is rising in value, stay invested. But have a rule for when you are going to sell. There are two elements on which to base that rule. The first is how much you are willing to lose, whether gains or principal. The second is the opportunity cost of having your money in an investment that isn't going anywhere.

Winners in a bear market are those who lose the least. That demands an active strategy. We welcome the opportunity to discuss our investment programs and how they have performed in the 2008 market decline with you and with any family members and friends who can benefit from an investment approach that recognizes the benefit of losing the least in bear markets and finding opportunities for profit in the carnage.

Dollar-cost averaging requires continuous investments in securities, regardless of fluctuation in price levels, and investors should consider their financial ability to continue purchases in changing market conditions. Such a plan does not assure a profit, nor protect against a loss in a declining market.

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