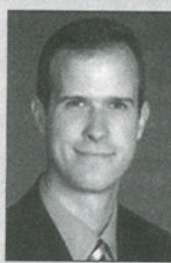


2011 Tax & Financial Planning Guide

Meet the investment panelists



Matthew Adams
Director of Investments, Partner
 Mission Wealth Management

Adams is responsible for portfolio management, trading, analysis and research functions, leads the investment committee, is a member of the executive committee and participates in the business development efforts of the firm.



Scott Estby
VP, Portfolio Manager
 Montecito Bank & Trust Wealth Management

Estby is responsible for the day-to-day management of client portfolios, investment research and portfolio analysis. Previously, he was an analyst at PlanMember Advisors Corp., an investment advisory firm in Carpinteria.



Peter Iannone
Director
 CBIZ Accounting, Tax & Advisory Services

Iannone manages CBIZ's Southern California corporate governance practice, which provides consultative services for Sarbanes-Oxley 404 compliance and works with CEOs and financial officers in establishing their SOX 302 programs.



Robert Katch
President, Chief Investment Officer
 Manchester Financial

Katch founded the investment firm in 1990. Previously, he was the associate treasurer at Pepperdine University responsible for the oversight of the university's endowment portfolio.



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Setting a course on rough economic seas

The past year has seen corporate profits soar to record highs, consumer spending returning to peak levels and a new boom in technology stocks. But job gains remain sluggish, and the U.S. stock market is rattled day in and day out by the sagas of the European sovereign debt crises.

With that in mind, the Business Times asked four tri-county investment experts to give us their take on navigating the investment environment and their outlooks for 2012.

Business Times: Double-dip or no double-dip? When do you expect to see a stronger recovery in the U.S., especially in terms of notable job gains?

Matthew Adams: We are expecting the United States to grow at roughly 2.1 percent in 2012. However, should the Bush-era tax cuts be allowed to expire, the combination of the Super Committee spending cuts as well as other cuts

will create a minus 3 percent headwind to growth and make a recession likely in 2013.

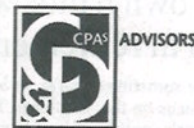
Scott Estby: The U.S. economy seems likely to avoid a double-dip recession. However, growth is likely to continue at a disappointingly slow rate as consumers are likely to continue paying down debts that were accumulated over the course of many years. This adjustment process will be healthy for the economy in the long run, but it will be a slow process.

While most of the economic headlines are about the sovereign debt problems facing Europe or declining home prices in the U.S., not all of the news is bad. Recent employment data have shown positive trends with layoffs announcements declining and new job openings increasing. As the third-quarter earnings season

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winds down, we learned that profits have grown more than 16 percent over the last year and are expected to grow a healthy 10 percent next year. In addition, corporate balance sheets have large cash balances earning next to nothing — eventually that cash is likely to be a source of investment as companies look for growth.

Peter Iannone: Personally, I am concerned that there is significant risk of a double dip. I am hoping that I'm just pessimistic, but the real lack of improvement in job growth is concerning. I believe that there is a strong possibility that the current small uptick in consumer optimism will fade very quickly.

Robert Katch: The Japanese earthquake and tsunami did sufficient damage to the global supply chain to make it feel like a recession was beginning in the U.S. But these forces proved transitory and U.S. production has increased over the past few months as Japan has started to work again. We don't have the preconditions for a recession in the U.S.

Any reading above 50 on the Institute for Supply Management Index indicates economic expansion. The ISM Index has stayed above 50 for the past 17 months, hitting a low of 52.7 during the summer,

before moving back up to 53. The Purchasing Managers Index has confirmed economic expansion for the past 25 months. Corporate profits are at record levels, rising 17 percent in the first half of 2011 and are now above their previous highs in 2007. In contrast, the stock market is still well below its 2007 high.

The U.S. will experience very low growth for several more years and the weakness in Europe will add to our problems. Europe, due to its tighter fiscal policies and austerity measures, will likely experience a mild recession over the next few quarters with improvement showing up in late 2012.

However, we have yet to sow the seeds of a sustainable U.S. recovery in the form of employment. For that to occur, corporations will need to see that taxes, regulations, and the general business climate will improve. They will wait until the 2012 election makes their choices more clear.

Business Times: How should the Eurozone mess fit into the American investor's thinking? How do investors guard themselves against risk? Does Europe present any opportunities for savvy players?

Adams: The American investor must keep Europe in mind as it is indicative of problems across the developed markets.

Europe's choice to address its debt issues via austerity measures for years to come will likely result in very low economic growth and potentially the "rolling recessions" most recently seen in Japan. There are certainly opportunities though, like the near 25 percent rally in three weeks' time in October. Savvy investors need a re-balancing strategy to take advantage of opportunities such as these.

Estby: There are no longer any good answers to solve the Eurozone debt crisis. The least painful option (and therefore most likely) is for the European Central Bank to purchase the bonds of its weaker member states such as Portugal, Ireland, Italy, Greece and Spain. While this carries the risk of higher inflation, it is more palatable than the current austerity measures, which are pushing the Eurozone into a recession and potentially threatening a break-up of the Euro.

However, given the need to negotiate a policy response among the 17 individual governments of the European Union, the "Eurozone mess" is likely to be part of the investment landscape for some time to come. When those negotiations lean toward "austerity solutions," the equity markets are likely to fall and when "debt monetization solutions" are discussed, stocks are likely to gain ground.

In general, we have reduced exposure to European stocks and avoided exposure to European banks. However, in some cases investors appear to have thrown the baby out with the bathwater and there are opportunities to buy multinational companies that are headquartered in Europe but which sell their products around the globe.

Iannone: The Eurozone is significant to the U.S. economy. The economy today is much more globally connected now than in the past. Fiscal problems in Europe or the Pacific Rim cannot be ignored, or perceived as an advantage to the U.S. and its economy.

Katch: A few months ago the markets were positioning themselves as if the world was going to end rapidly. Now that level heads have prevailed and investors believe that it will merely end slowly, we've had a great rally.

During late June and early July, I spent 10 days in Berlin and two weeks in Greece. While the thrifty Germans don't want to bail out the profligate Greeks, they believe they need to and will do so once they've extracted the maximum fiscal pain. The Greeks don't want their lazy and corrupt system to come to an end, but they know they need to be in the European Union, so they will grow up. Both countries will do the right thing in the end.

If we could all see behind the closed doors and see through all the European bickering, the one guiding force is integration versus irrelevance. If the Europeans don't find a way to further integrate their economies, then most of them will

be economically irrelevant 10 years from now. Their best hope is to stick together in an economic block big enough to matter. We believe the EU will find a solution.

Here's a look at working with the risk created by Europe:

Treasuries: Over the past few months the most consistent protection against risk has been delivered by long-dated U.S. Treasuries. While we are not big fans of investing in U.S. debt for the long run, Treasuries have consistently gone up in price when money flees Europe and the stock market. Securities such as AGG, BND and TLT have all delivered in the crisis.

Gold: During the early part of the crisis, gold worked well to protect portfolios. But since mid-September it has no longer provided consistent and reliable protection. However, should the situation get out of hand, I would expect gold to be a safe-haven once again. Securities such as GLD and IAU have worked well, but if you're worried about a true global meltdown, then CEF or gold bullion would likely do better.

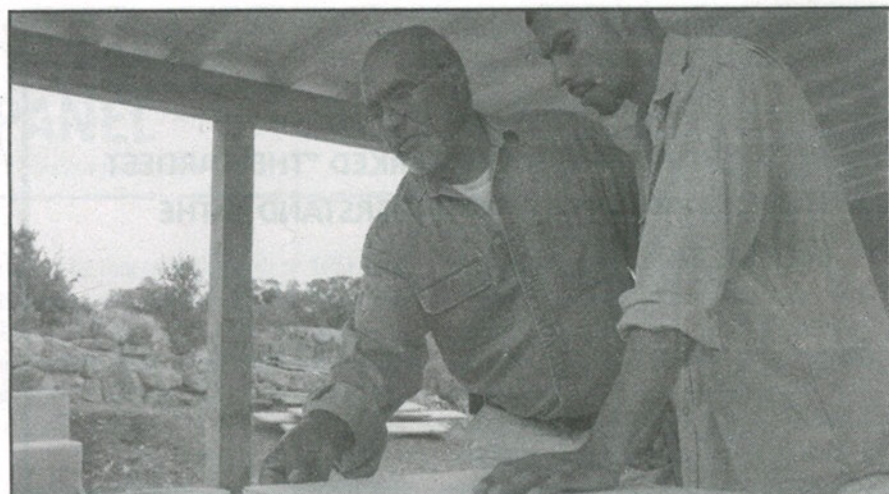
Short the euro: A great hedge is one that provides good protection if you need it and won't hurt too much if the situation goes the other way. Shorting the euro through a security such as DRR might work very well if Europe unravels, but isn't likely to move aggressively if the situation improves.

Emerging markets' debt and equity will continue to do well in the years ahead as such countries are growing their middle class, have increasing populations, and are generally not encumbered by national debt or rising deficits. Emerging markets have been bloodied this year. Their prices are down considerably more than U.S. markets even though growth has been good. While the U.S. has been lowering its interest rates over the past few years to goose our anemic economy, many developing nations have been raising their interest rates to slow growth and thwart inflation. Once they have it under control and begin to lower their interest rates ... look out, as their stock markets will take off once again.

Our concern about most emerging markets equity funds is that they generally stay fairly tight to their indexes, which are loaded with global commodities companies. As such, most emerging markets funds are much more volatile. However, there are a few funds, such as HIEMX, that avoid such exposure and focus instead on companies that will thrive as standards of living continue to rise in the developing world.

It is not that we don't like commodities as an investment. We just prefer to do them separately from our emerging markets allocations. Corporate bonds with higher coupons, maturities laddered from four to 10 years, and credit ratings

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between "BB" and "A" will provide yields from 5 percent to 8 percent. These returns will go a long way to cushion a portfolio in the years ahead and the laddering will help ride through the bumps of rising rates in the future. Commodities will be a solid investment over the years ahead, but quite volatile.

Business Times: Aside from cutting off Internet and TV access, how do investors stay sane and deal with the nonstop volatility in the U.S. stock market? Do the day-to-day rises and falls really matter, or are there longer-term trends that you're watching for more closely?

Adams: The average investor would do well to realize that the day-to-day volatility is partially due to high frequency and algorithmic trading. Markets today are less centralized and offer fewer shares at any given point in time, making them more susceptible to swings in either direction. At Mission Wealth, we are keeping an eye on record corporate profits (generally a positive for stocks) as well as global sovereign debt concerns (including those in the United States).

Estby: Unfortunately, there is no magic bullet to avoid market volatility. The best method of dealing with volatility is to develop an appropriate asset-allocation strategy that balances the long-term needs and the risk tolerance of each investor. For investors that have long-term goals, such as saving for retirement, the day-to-day movement in stock prices is the trade-off for earning higher rates of return over longer time periods.

One of the ways to avoid being swept up in the panic of volatile markets is to recognize that all investments represent a claim on a future earnings power and dividends. While stock (or bond) prices can move significantly over short periods of time, the income an investor can expect to receive in the form of dividends is generally much more stable and reliable. This is why we like to look for companies with sustainable business models, strong balance sheets and high levels of free cash flow.

Katch: As Wall Street's supercomputers cause the markets to gyrate from day to day, the average investor needs to be more vigilant than ever to make sure their nest eggs aren't scrambled. The volatility only matters to the extent that it destroys confidence. Over the past few weeks and months, the pick-up in volatility has damaged investor confidence and willingness to participate in the market. Market crashes and corrections are like earthquakes and the volatility that follows are the aftershocks. They are natural and normal, but that does not make them any less frightening to most. Over time, they

dissipate.

Some long-term trends to look at instead: Over the next five to 10 years, U.S. stocks will outperform U.S. Treasury bonds (see the big-cap discussion below). On Sept. 30, 1981 you could have purchased a 30-year Treasury bond and locked in an annual return more than 15 percent. Now, that same bond will pay you just over 3 percent annually for the next 30 years. Then, nobody wanted them and now they are so popular that they rose more than 30 percent in the past year. Even worse, the duration on a 30-year Treasury yielding 3 percent is about 19, which means that if interest rates rise 1 percent, the bond's price should drop 19 percent, wiping out the next six years' re-

turn! Securities such as TBT will shine when this sea change occurs.

Business Times: 2011 was the biggest Internet IPO year since 2000, with LinkedIn, Pandora and Groupon all going public, and a flurry of speculation on when Facebook will do so. What are your thoughts on the recent tech boom? Is this something you're investing in for your clients?

Estby: While some of the social media IPOs have generated eye-popping one-day returns, we are more focused on investing in technology companies that enhance productivity. Many companies have been cautious to build new factories or hire new workers in the current slow-growth

environment despite having record levels of cash on their balance sheets. However, businesses have shown a willingness to invest in technology that can pay for itself by reducing costs or enhancing operating efficiencies through improved business intelligence and flexibility.

Katch: Most of the more recent crop of Internet IPOs have been solid companies with good to great long-run potential. Gone are the days where a mere business plan could raise you millions. While there is still much hype with each new IPO, the bigger story is that most of the insiders have been reducing their exposure during the months and years before the IPO. It

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used to be that only through an IPO could founders and employees cash out of their stock holdings. But with the advent of businesses such as SharesPost, insiders have been selling shares to accredited investors for years.

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Business Times: Small-, mid- or big-cap stocks? Which way are you leaning over the next year, and why?

Adams: We build our models based on global market caps and re-balance back to those weightings quarterly. So, we do not specifically favor any one area, but rather look to take advantage of any relative moves (plus or minus) via our quarterly re-balance adjustments.

Estby: Within our framework of constructing diversified equity portfolios we continue to tilt portfolios toward large-cap stocks. We favor large-cap stocks for two reasons:

First, large-cap stocks are priced more attractively than small- and mid-cap stocks. Large-cap stocks as represented by the S&P 500 trade at a relative modest 13 times trailing earnings while small and mid-cap stocks are trading at 21 and

17 times earnings, respectively.

Second, large-cap stocks have more exposure to the faster growth of emerging markets, whereas small-cap stocks tend to be more oriented to the slower growing domestic economy.

Katch: Large companies are very global and many are generating huge amounts of free cash flow. Their global brands mean they are desirable and well positioned and their global reach means that they can participate in the growth of emerging markets. They are so global that they have done well despite two bad U.S. recessions over the past 10 years.

Corporate America is healthy and it is consumers and government that are strapped. The economic performance of most major companies has been quite strong. Earnings and cash flow are rising and corporate balance sheets are in good shape, yet their stock prices have fallen. For example, ExxonMobil is only one of four "AAA" rated companies in the U.S. and it runs a cash surplus of about 10 percent each year. Over the past 10 years it has repurchased over 40 percent of its stock market capitalization. For 2011, it will spend another \$20 billion buying back its own shares. If that money were paid out as a dividend, the stock would yield near 8 percent instead of its current 2.4 percent yield. The stock buyback is

good for taxable investors as it turns what would have been ordinary income into capital gain.

• • •
Business Times: What's your investment and economic outlook for 2012? In which specific areas do you see opportunities?

Adams: Our 2012 outlook is for developed economies to grow at 0 to 2 percent as they pursue austerity measures and reduce their dependence on debt. Emerging economies should grow at 4 to 7 percent and remain the most attractive long-term investments. Corporate profits are at all-time highs; interest rates are at all time lows – typically an environment that would favor stocks. We feel commodities will likely move higher based on the relentless demand of emerging markets.

Housing will remain under pressure and continue to be a drag on consumer spending. With over 10 million mortgages 60 days or more delinquent, there is a significant supply overhang to overcome.

Estby: In general, we think 2012 is going to look similar to 2011 as the economy is likely to muddle through. Stronger economic growth will be held back by the deleveraging process as consumers continue to pay down debts and rebuild savings. Given the weakness of the economy, investors will continue to worry about the

sustainability of the recovery, which will cause the equity markets to be more volatile than they have been historically.

One of the hallmarks of the current economic environment is the persistence of extremely low yields. Currently, 10-year Treasury yields are near all time lows of around 2 percent. One of the most enduring investment maxims is to buy what's scarce and sell what's abundant. In the current environment, safe income is scarce. As a result, we are buying stocks with strong balance sheets, stable businesses and high-dividend yields.

In the current low-yield environment, we think it makes sense to look for safe ways to generate current income. In addition to earning income from dividend payments, we think the stocks will move higher as investors start to focus more on stocks with safe dividends with yields higher than Treasuries. Some stocks fitting that criteria are Johnson & Johnson, with a dividend yield over 3.5 percent; Kinder Morgan, with a dividend yield over 6 percent; and Annaly Capital, with a yield over 14 percent.

Katch: We see continued slow growth for many years, but 2012 should be an improvement over 2011. All incumbent U.S. presidents do what they can to shower the voters with better times leading up to an election. Obama will be no different.