WINFIELD
ASSOCIATES

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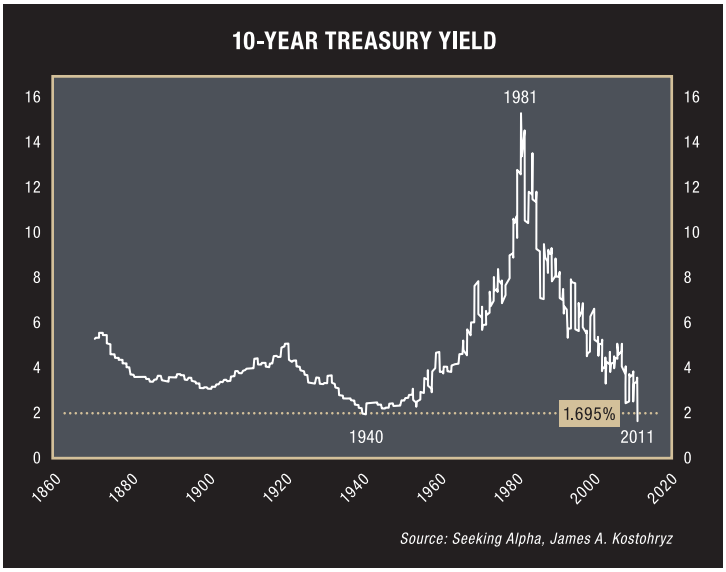
Customized Investment Portfolios and Private Wealth Advisory Services

MARKET COMMENTARY

The performance of major equity indexes in the third quarter of 2011 was abysmal. The S&P 500 Index declined -13.84%, the largest third quarter decline since 1928. Other indexes, including the Russell 2000 declined -22.15%, and the MSCI Europe Asia Far East Index (EAFE) Index dropped -19.60%. Uncertainty regarding the global economy dominated investors' actions. Fear of a double dip recession in the US, a very likely recession in Europe and slowing growth in emerging markets caused investors to seek low risk assets. Despite threats of a possible US government default in August, investors poured into US debt, dropping the yield of the benchmark 10-year Treasury bond to an all-time record low of 1.695% on September 22. The graph below illustrates 140 years of the yield of the 10-year. Previously, yields have only been close to 2% twice: just prior to World War II and in 2008.



Reminiscent of 2008, credit markets reflected world-wide fear of illiquidity and default during much of the third quarter of 2011. This year, however, investors' concerns are not US mortgage debt, but the severity of European sovereign debt and its effect on other economies. Daily news from Greece concerning off and on funding and the threat of contagion from its possible default seemed to determine the direction of equity markets in the third quarter. The European Union (EU) has reacted to the crisis by establishing the European Financial Stability Facility (EFSF) which will provide funds for the ailing countries and banks in the EU. The EFSF is similar to the US Troubled Asset Relief Program (TARP) of 2008 that successfully bailed out US banks and other financial services entities. Over most of the summer, issues and controversy raised about funding and distributing the EFSF funds were a source of volatility. Hopefully, EU member countries will settle their differences by mid-November, and the funds will become available.

In addition to the European financial crisis, US markets were impacted by the Standard & Poor's downgrade of US Treasuries from AAA status to AA plus on Aug 5. This move created considerable angst concerning the cost of loans to corporations and individuals. The bond market met the news with relative indifference while equities suffered due to perceived risk in the economy. Other issues weighed on the markets during the quarter including ongoing Congressional inaction dealing with the debt ceiling and the cost of running the government in general. Perhaps more than ever, investors sense a lack of confidence in our policy makers and their resolve to avoid a credit crisis like 2008-2009.

US unemployment continues to nag policy makers. No area has felt the impact more than home building and construction. At the height of the housing boom, the construction industry employed 8 million people. Following the financial crisis in 2008-2009, over 2 million people in the industry lost their jobs. While Congress and the Federal Reserve try to affect change, the structural nature of the dilemma presents a unique set of challenges. The Fed's latest move, termed "Operation Twist," is an attempt to lower longer term interest rates by purchasing long dated US Treasuries. The announcement of the program exacerbated the drop in long–term yields as described above.

Fears of a hard landing in emerging markets also weighed on stocks in the third quarter. No emerging market generates as much attention as China. By the end of 2011, China's GDP will reach nearly $6 trillion, growing at 9% compared to the US's $15 trillion, growing at 2%. During 2011, concerns surrounding slowing demand in China have led to declining world prices for commodities. In turn, the stocks of US and other country mining, agriculture and machinery companies have generally declined. Some speculate that China was merely de-stocking during the second and third quarters, and may resume purchasing commodities in the fourth quarter as demand recovers. In the long run, the key to the sustainability of the global recovery after the shock of 2008-2009 is the ability of China and other emerging markets to transform from export producing economies to consuming economies.

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Despite an outlook of slowing growth for many economies, investors should not lose sight of investment values and the resilience of markets. Many fundamentals are intact. Stocks are reasonably valued at 11.0–12.0 times 2012 estimated earnings, below the historical market multiple of 15.4 times. S&P 500 Index companies are sitting on more money than ever after boosting cash, equivalents and short–term securities for 10 straight quarters to about $2.8 trillion. This figure is up 15% from the end of last year and 66% more than in December 2007 when the financial crisis started. Book value of the S&P 500 is 1.95 times market value (historical average 2.40), and the dividend yield of the benchmark index now exceeds the yield of long-term Treasuries. By most measures, equities are inexpensive.

Our investment strategy over the summer was to retain or increase fixed income and cash positions as economic risks increased. With equity prices at lower levels and dividend yields increasing, bond prices appear relatively expensive. Even though the data is more evident the US will not dip into a recession, and Europe's crisis may be resolved, earnings forecasts for 2012 and 2013 present considerable uncertainty. In the coming weeks, the economic outlook will become more evident with the reporting of third quarter earnings and guidance for the fourth quarter and full year 2012.

2011 YEAR-END TAX PLANNING

Year-end tax planning is especially challenging this year because of uncertainty over whether Congress will enact sweeping tax reform that could have a major impact in 2012 and beyond. And even if there's no major tax legislation in the immediate future, next year Congress will have to address significant fiscal policy issues, such as whether to once again "patch" the alternative minimum tax, eliminate the post-2012 expiration of the Bush-era income tax cuts (including the current rate schedules, and low tax rates for long-term capital gains and qualified dividends), and the expiration of favorable estate and gift rules for estates of decedents dying, gifts made, or generation-skipping transfers made after Dec. 31, 2012.

REQUIRED MINIMUM DISTRIBUTION

Individuals are generally required to withdraw a minimum amount of money from tax–advantaged retirement accounts each year beginning the calendar year after turning 70½. This amount is called a Required Minimum Distribution (RMD). Individuals must take RMDs from any retirement account that included tax–deferred assets or had tax–deferred earnings. These accounts include:

- Traditional IRAs
- SIMPLE IRAs
- Most Keogh accounts
- Rollover IRAs
- SEP–IRAs
- Most 401(k) and 403(b) plans

Annual RMDs may be taken in one distribution or periodic withdrawals throughout the year, but the total annual minimum amount must be withdrawn by the deadline of December 31. Of note, individuals can always take more than the RMD amount. Please contact us if you have questions.

MARKET PERFORMANCE

	3Q 2011	2011 YTD
Dow Jones	-11.48%	-3.87%
S&P 500	-13.84%	-8.59%
Nasdaq	-12.91%	-8.95%
Russell 2000	-22.15%	-17.80%
MSCI EAFE	-19.60%	-17.19%
Barclays Agg	3.82%	6.65%

WHEN TO WORK WITH WINFIELD

PRIVATE INDIVIDUAL INVESTORS

- Manage accumulated wealth, inheritances and settlements to meet investment objectives

ENDOWMENTS AND FOUNDATIONS

- Manage assets with a long-term growth strategy while meeting investment policy requirements

BUSINESS OWNERS

- Customize investment portfolios to meet investment objectives and lessen risk of concentrated assets
- Defer taxable earnings in profit sharing plans
- Manage and advise 401(k) plans

BUSINESS PROFESSIONALS

- Customize investment portfolios, manage stock options and consolidate 401(k)/IRA plans to meet investment objectives and lessen risk of concentrated assets

RETIREES

- Customize investment portfolios to meet investment objectives with the option of drawing income
- Management of IRAs, trusts and taxable accounts

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