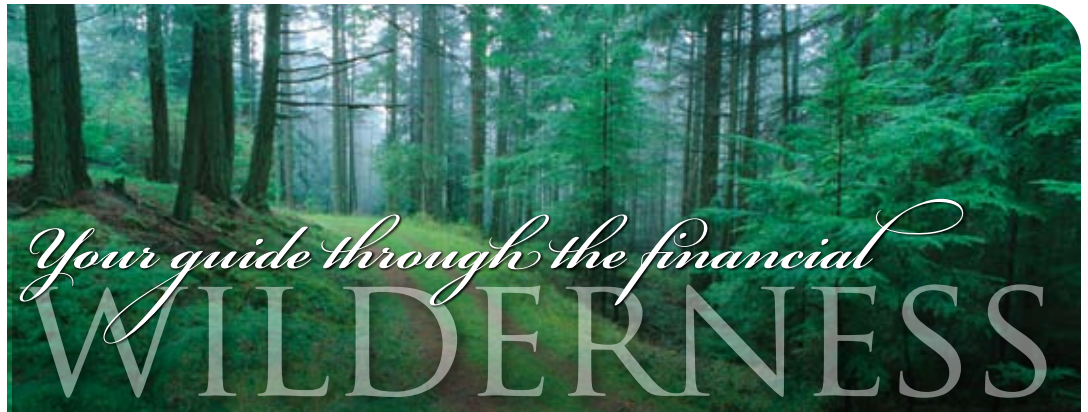




CLAYTON FINANCIAL SERVICES, INC.

Registered Investment Advisor



Q4, 2008

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Guarded Optimism for '09

There have been many times we would have cheered a gain of 24% in the S&P 500. But not now...not this time. From November 20, 2008 to January 6, 2009 the index gave us a nice little Santa Claus rally of 24% but from a quick review of newspaper headlines, investors weren't interested. Instead we were reminded the Nasdaq Composite Index fell 40.5% in 2008, more than it declined in 2000 after the tech-stock bubble burst. The S&P 500 was down 38.5% for the year of 2008—its worst year since 1937. The venerable Dow Jones Industrial's decline of 33.8% was a little better but 2008 was its worst year since 1931. We're not used to comparisons to the Great Depression and economists are quick to point out no one is predicting 25% unemployment and a return to soup lines. It was, however, a bear market brought about by a crisis in the financial sector and so the comparisons are more apt—not only the market decline and the volatility but the changes in Wall Street institutions and the call for additional regulations.

Perhaps the year end rally didn't attract much attention because in October we'd seen the Dow enjoy two of the six biggest one-day percentage gains in its history—only to give back those gains and fall to new lows. Is that the case this time? Perhaps. After all, the S&P

by **Debra Clayton**
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retreated about 7% from January 6 to January 12; maybe this is another rally that will run out of steam and take us to new lows. And the reasoning to back up that thinking is persuasive. The economy could be weak for months to come. We are 13 months into a recession

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and if it goes past March we could surpass the recessions ending in 1975 and 1982 that were each 16 months long. The banking system and housing markets show little sign of returning to normal and in fact housing prices may fall another 5-10% in 2009. People are risk averse, preferring to hold Treasury

securities even though they may end up with a negative real rate of return. It's possible Americans may become savers, which would be a good thing, although it would be a radical change for an economy that is 70% dependent on the consumer.

At some point, however, the stock market will hit bottom and move higher. Some people believe the market hit that low in November and are guardedly optimistic about

continued on next page...

Guarded Optimism... *continued from page 1*



Elizabeth Young

Maternity Leave

Next month Associate Planner Elizabeth Young will be going on maternity leave. She, husband Adam, and big sister Kendall are expecting a little girl February 21st. Elizabeth plans to work until her due date and will then be out of the office for six weeks. Planners Barbara Heller, Debbie Bausch, and Anna Kiser will be handling questions from clients Elizabeth ordinarily works with until she returns.

2009. They are hopeful policy makers can be successful in stabilizing the economy and credit markets and getting banks to loan again. The monetary and fiscal stimulus would lift the economy out of a recession by the second half of the year and the stock market—as a leading indicator—would rally before that.

Last November many of you came to a seminar we held discussing the market and our expectations. At that time we presented several charts—admittedly difficult to see in detail on the screen—developed by respected investment research firm Ned Davis Research. Their work showed similarities between our current market and previous bear markets including a gut wrenching ‘waterfall’ decline followed by a market rally and then the ultimate bear market low. At that time we discussed the probability the ‘waterfall’ decline ended in October and it appears possible the low in November was the bear market bottom. Subsequent rallies after a bear market bottom can be dramatic with gains of 51% (1974-75) to 60% (1938). So far the pattern appears to be developing consistent with those comparisons and we have been nudging portfolios into positions reflecting a neutral weighting of stocks and bonds as indicated by each Investment Policy Statement.

However, we’re not yet comfortable identifying November as the market low but

prefer to continue to view this as part of the ‘bottoming process.’ Most importantly we would like to see a broader participation of stocks. If that were the case, we can again look to history to see the categories that do well at this stage. These frequently include investments that were oversold on the decline, including small caps and emerging markets. And indeed we see that these investments outperformed in the rally beginning in November. Interestingly the

Chinese market was strong, suggesting China’s economy will recover more decisively than perhaps those economies more directly exposed to the credit crisis. Latin American markets have been relatively strong which may indicate strengthening commodity prices since those markets

are resource-based. If so, we can look at incorporating ETFs (exchange traded funds) that invest in real assets such as metals and energy into our portfolios.

If we have indeed seen the bottom of the bear market and have a strong rally—bull market—off the November lows our best guess is that a correction would occur late summer. What happens after that will depend a lot upon the health of the economy. If inflation is contained and the economy is improving a normal market correction would be likely with a subsequent resumption of increasing stock prices. If the outlook

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is less cheery, it could mark the beginning of another bear market. Under either scenario we anticipate being very cautious late summer. As we mentioned at the seminar, we can no longer focus only on developing diversified asset allocation and then using good investments to implement the plan. We must be more strategic in our thinking. That doesn't mean turning portfolios into trading vehicles but it does mean looking at a wider range of investment possibilities and using shorter time horizons.

In that vein, we have to also look at what could go wrong and as I mentioned in paragraph two there are plenty of possibilities. Most importantly, many of the actions being taken by the Federal Reserve and the Treasury are new and untested. They could be creative, effective actions that are studied in economic and finance classrooms well into the future. They could also have unintended consequences. As such we must also be vigilant and ready to forego asset growth in favor of asset protection. Last year was a difficult year for all and we hope we were responsive to your concerns and fears. We're hopeful 2009 will provide more buoyant times and we will be able to focus on other planning issues, but as always, feel free to contact us with any of your financial concerns.

Estate Tax Exemption Amount Raised

In 2000 Congress approved a schedule that increases the amount an individual can leave to heirs tax-free. From 2006 to 2008 it was \$2 million. In 2009 estates of up to \$3.5 million (\$7 million for a married couple) are exempt from federal estate tax. Assets and insurance death benefits in excess of this amount are subject to a 45 percent estate tax rate.

According to the schedule in 2010 the federal estate tax will be repealed altogether. But don't get excited, because in 2010 the schedule includes a capital gains tax on inherited assets in excess of \$1.3 million. Currently most Americans inherit assets with a "stepped-up" basis, which means if they sold the asset before any additional appreciation occurred there wouldn't be a capital gains tax to pay on the inherited asset. It's not clear how that would be handled under current law.

Then in 2011 the estate tax laws revert (sunset) back to the year 2000 rules, which limit estates to \$1 million before a 55% tax rate is applied.

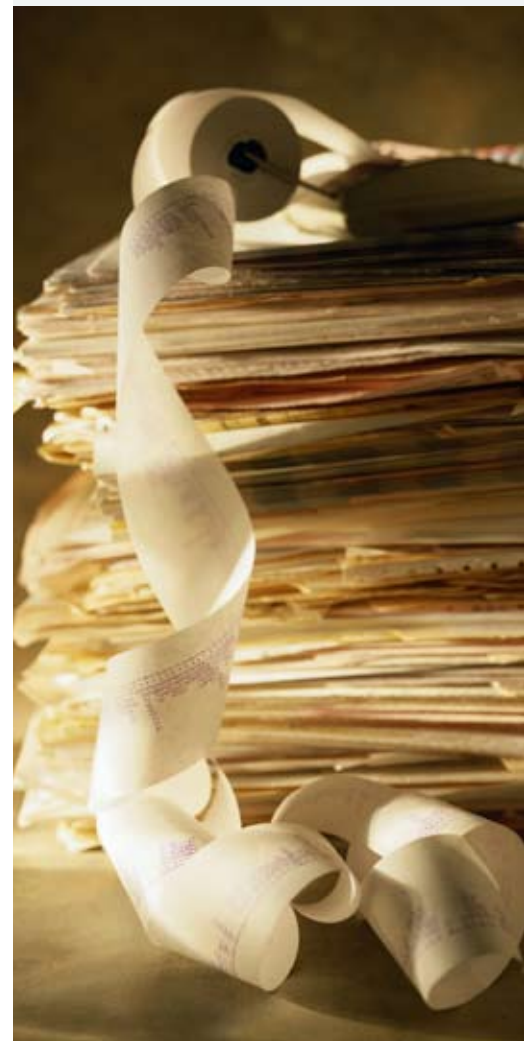
During his campaign President-elect Obama proposed leaving the \$3.5 million (\$7 million for a married couple) intact, without a repeal in 2010 and without a reversion in 2011. This is estimated to eliminate estate taxes for 99.7% of the American population. What is still unclear about this proposal are the provisions for capital gain taxes.

This year the law is clear. However, we anticipate Congress will review estate taxes this year and it's likely there will be changes to what the tax will look like in subsequent years. We will be watching the situation and will continue to work with you and your attorney to develop a plan to maximize the amount you can leave your heirs.

It's that time of year..... (Tax Information)

This month Fidelity will be sending the majority of its tax statements. For those with limited partnerships, unit trusts or other investments whose information is reported to Fidelity from a third-party, the tax statement will not come from Fidelity until late February. This will have little impact on the majority of our clients, but please do not take your information to your tax preparer or enter your data into Turbo-Tax until you have the Fidelity 2008 Tax Reporting Statement.

Later this month we will be sending out statements giving you the tax basis for assets sold in your non-qualified accounts. These envelopes will also be stamped 'Tax Information' and should be put with your other documents to go to your tax preparer.



Suspension of RMD rules

In December, President Bush signed into law new legislation that allows individuals who are subject to Required Minimum Distribution (RMD) rules to suspend required minimum distributions from their retirement plans or IRAs in 2009 without penalty. This law is intended to provide relief to individuals who do not wish to take a withdrawal during this next year while the market has suffered such a decline. However, if individuals wish to continue their current planned distributions, they may do so without penalty. If you have any questions or would like more information, please give our office a call.

by **Barbara Heller**
CFP®



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