

## Economic Outlook - 4<sup>th</sup> Quarter Trends Indicate Increased Spending In 2008



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An array of negative developments — escalating crude oil prices, lingering problems in the credit markets and a deepening housing slump—is expected to depress real GDP growth below 2% in the current fourth quarter. Resilience of the economy, reflected by an unemployment rate still in the historically low 4.7% range, and consistent gains in real personal income, indicate moderate improvement in consumer spending in 2008 that could spark 2.5% GDP growth.

Supporting this outlook, exports remain strong following the decline in the dollar's foreign exchange value, and business capital spending for plant, equipment, and software should improve

as the battle for global market share intensifies. The current environment is signaling consumer price inflation in the 2.5% range in 2008. Consequently both short-term and long-term interest rates should remain relatively stable over the next year.

Further easing by the Fed is problematic. Officials have said recent cuts in the fed funds target rate should not be seen as the beginning of an aggressive easing cycle. Instead, the Fed will accept further slowing in growth before cutting rates again. The reasons: policy lags and concern over fuelling inflationary

psychology. A primary mission of the Fed is to sustain confidence in the credit markets. Therefore, periodic statements can be expected that officials are monitoring developments in the mortgage and derivatives sectors to reassure participants they are aware of developments. ■

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## Municipal Holdings Insurers Under Stress and Taking Write-offs

In the wake of the sub-prime mortgage default crisis, several of the municipal bond insurance companies including MBIA, Ambac Financial Group, FSA, FGIC, ACA Capital, and Radian Group are set to record massive losses (industry estimates are in the tens of billions) due to holdings and guarantees. These losses will require that they raise new capital to maintain their current ratings and the ability to do so is going to be severely

tested. On the positive side, a good majority of insured municipal bonds are well rated and financially secure on their own financial condition; a downgrade of the insurance rating will have little impact on their ability to meet their debt service.

A review of your bond portfolio's underlying creditworthiness is a timely and prudent exercise. Please contact your Wayne Hummer professional today to review your current bond holdings. ■

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The tax planning information contained in this issue may answer some questions, but is not intended as a comprehensive analysis of the topic. Periodically, Wayne Hummer provides information to clients in the area of planning. Such services should not be relied upon as the only source of information, competent tax and legal advice should always be obtained.

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# MARKET LETTER

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## Keys to Financial Planning

Just Do It. By: Samuel C. Carpenter, Financial Architect

**"The great French Marshall Lyautey once asked his gardener to plant a tree. The gardener objected that the tree was slow growing and would not reach maturity for 100 years. The Marshall replied, 'In that case, there is no time to lose; plant it this afternoon!'" ~ John F. Kennedy**

The rewards of financial planning may seem to be like the tree in the quote; very slow in coming. Likewise, the events tied to planning stages often appear far off or only a remote possibility. Examples include college tuition, retirement, disability, and long-term care. The perceived effort required, coupled with the long lead time to receive the rewards, often leads to a delay in action.

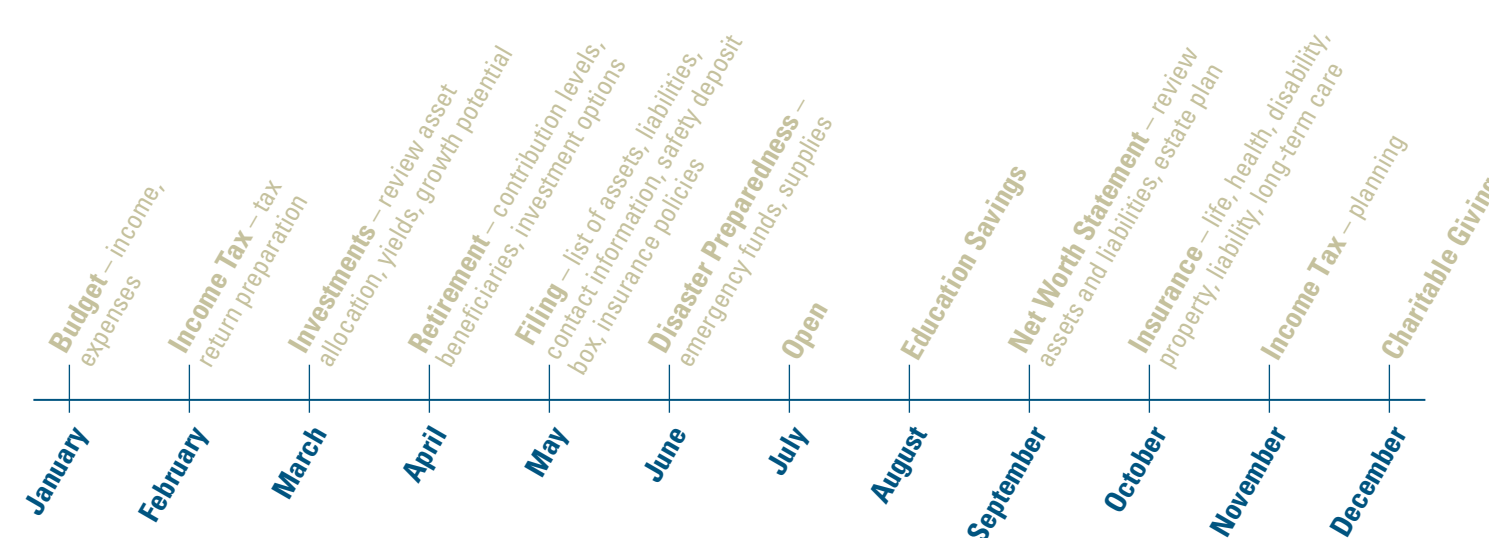
Some of the causes for procrastination can be overcome by taking one piece at a time, working on a specific planning area rather than trying to get everything done at once. You can also assign different topics to different months of the year.

This is a good habit to get into even after you finish your first run through of the topics, so that you can monitor your progress and make any adjustments based on life events or other developments. To bring some immediacy to the rewards and shorten the time horizon, try working on themes that have seasonal application. For example, spending some time in the next few weeks (before year end) on tax planning items that may have an impact as soon as January 15, 2008 for those making estimated tax payments and April 15, 2008 for others.

The schedule below leaves July open for vacation or catch up as needed. There may be other items that are important to

you that could be added to the list. The point is to find a system that is useful for your specific situation.

Remember, you do not need to do this alone. If you haven't had a Comprehensive Financial Review™, please call your Wayne Hummer professional to get one started. The process will help identify the areas that need your immediate attention. If you have already had a review, do not forget to update it periodically with your Wayne Hummer professional. ■



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# Family Estate Planning

## Not Just for the Rich and Famous

Family estate planning is no longer for the rich and famous alone. It is for anyone who wishes to control the distribution of assets, name the guardian of dependents, and reduce the tax burden to heirs. While attorney's fees will be incurred in the short run, the cost savings and peace of mind in the long run can be well worth it. Failure to plan can create conflict among family members and result in unnecessary expenses for your heirs. Estate taxes alone can eat away nearly half of what you want to leave to them.

There are generally four basic steps to begin the estate-planning process:

- Gather all personal and family information and decide whom you wish to benefit.
- Take an inventory of your assets and liabilities in order to determine your personal net worth.
- Decide what you would like to accomplish and rank these objectives in order of priority.
- Consult with a qualified attorney who can help you identify the best legal plan and strategies to meet your goals and objectives.

Every person is currently allowed to transfer up to \$2 million in assets to their heirs free of Federal estate tax. This amount, known as the unified credit exemption equivalent, will increase to \$3.5 million in 2009, will be unlimited in 2010, and will return to \$1 million in 2011 and beyond. While this may seem like a large amount, it includes life insurance proceeds, future inheritances, and corporate stock options as well as investment and personal assets. One goal of your estate plan should be to make maximum use of this unified credit exemption amount. Consideration should also be given to state estate taxes.

A will traditionally has been the cornerstone of most estate plans, and it is still important. Your will may be used

to appoint an executor to manage and settle your estate, detail how your property will be distributed upon your death, and designate the guardian for your children if necessary.

After your death, the executor will administer and settle your estate through probate. Probate is the process of the court-supervised transfer of a decedent's assets in the manner provided by a valid will.

Because of the public nature of the proceedings, delays, and costs involved with probate, many people try to avoid it. Some assets, by their nature or registration, will automatically pass to heirs without probate. Examples include life insurance, individual retirement accounts, retirement plans, transfer-on-death registered accounts, property held in joint tenancy with rights of survivorship, and property held in a living trust.

Another way to avoid probate and minimize estate taxes is to gift a portion of your estate before your death. You can take advantage of the annual gift-tax exclusion of \$12,000 per recipient. Together, a husband and wife can gift up to \$24,000 annually to any individual. This figure will be indexed for inflation in \$1,000 increments. Monetary gifts of any amount that are used to pay for qualified medical expenses or school tuition are also tax-free, provided the money is sent directly to a school or medical provider.

Trusts are another popular estate-planning tool. A trust can help you manage assets even before your death. Depending upon the type of trust established it may be used to manage assets for your family in the event of your death, to avoid probate, or to minimize estate tax. Wayne Hummer Trust Company can help you determine which



type of trust is best for your needs.

With the help of your legal, accounting and financial advisors, you can explore various trust options. Some trusts allow cash to be removed only at the discretion of the trustee. Others may specify that the donor receive income from the trust while living, with the principal passing directly to heirs upon death.

Under the Tax Relief Act of 2001, the federal estate tax is gradually phased out and disappears in 2010. However, the Act does not apply after the end of the year 2010. Unless Congress takes further action, the 2001's rules, rates and exemptions come back into effect in 2011 – including the federal estate tax. This will lead to much uncertainty in estate planning. To find out more information and how this might affect you, contact your Wayne Hummer professional. ■

# Diversification and Asset Allocation

By: David D. Cox, Senior Portfolio Manager

At Wayne Hummer Wealth Management, we believe that asset allocation has, and will continue to represent, the foundation of effective portfolio management. Investors should always have robust diversification at each level of their portfolio. First, the portfolio should have representation across all of the major asset classes (equities, bonds, cash, and alternative investments - if suitable). Next, within each broad asset class – using equities as an example – the portfolio should own stocks in large capitalization, medium capitalization, and small capitalization domestic companies, as well as in international companies, both in developed and emerging economies. Finally, within each of these mandates,

broad diversification should exist at both the individual security and industry levels.

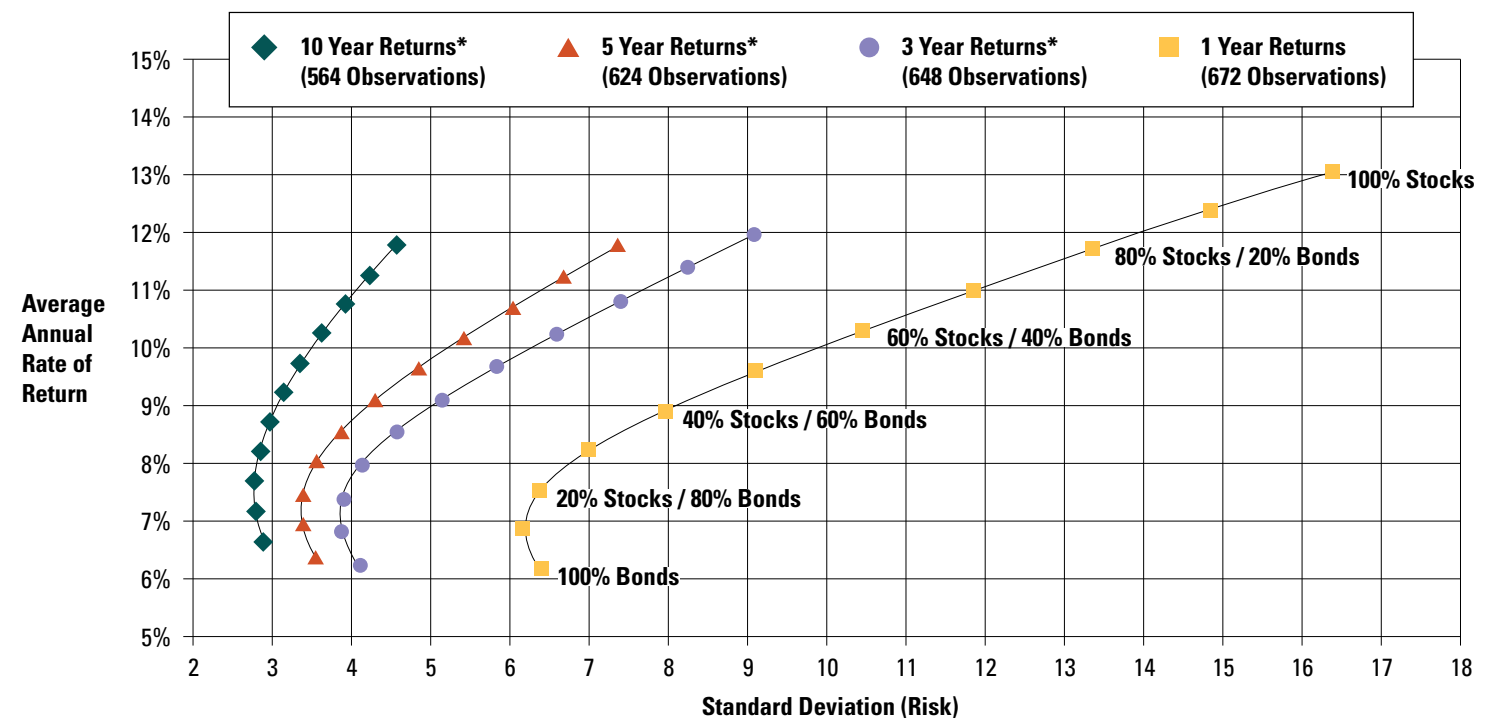
The notion of having these multiple levels of diversification is that in any one period – a month, a quarter, a year – certain components of the portfolio will be up in value while others will be down in value. Thus, by putting together a well diversified collection of assets, an investor can enjoy capital appreciation over longer periods of time, but in the month-to-month, quarter-to-quarter, or year-to-year time periods, negative movements in one asset class are partially offset by positive movements in another asset class. As a result, by investing in a variety of asset classes, you moderate the volatility, or risk, of the overall portfolio for any longer time period. An illustration of the

impact of diversification, in terms of both return and risk, over longer term time periods is displayed below.

Wayne Hummer Asset Management's Investment Policy Committee, on a tactical basis, carefully assesses the investment climate to determine if a greater or lesser emphasis should be placed on each of the individual asset classes, with the goal to maximize the potential return for a given level of risk.

Investors should revisit their asset allocation at least annually. Contact your Wayne Hummer professional to review your asset allocation to make sure it continues to be well diversified and aligned with your long term goals. ■

**Asset Allocation by Holding Period: S&P 500 / Five-Year Treasury Bonds**  
Total Return - Monthly Observations 1950 through December 2006



\*Compound Annual Return. Sources: Stocks: Standard & Poor's Corporation • Five-Year Treasury Bonds: Ryan Labs, Inc. The information presented herein was compiled from sources believed to be reliable. It is intended for illustrative purposes only, and is furnished without responsibility for completeness or accuracy. Past performance does not guarantee future results.