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THE Financial Standard

FALL 2010

Living With Volatility

Making the Most of Current Market Conditions

How do you respond to volatile markets? Do you find yourself making all the wrong moves when markets turn choppy? Occasional bouts of market volatility are a fact of life for investors. It is how you act in the face of volatility that may make all the difference in your long-term investment success.

Market Volatility: A Case Study

Stocks started 2010 on an up note, with the S&P 500 posting a gain of 9.2% through April 23 (the stock market's recent peak).¹ However, the good times gave way to anxiety for investors as the market began to reverse course. From April 23 to June 7, the S&P 500 declined 13.7% (on a closing basis), putting the index well within correction territory (a drop of 10% to 20%).²

During this time, investors, who remembered all too well the swiftness of the 2008 market meltdown, sold first and asked questions later, further fueling the volatility. Indeed the data show that in a matter of two months — from April 23 through June 25, 2010 — the index dropped by 2% or more five times. Compare that with an average of seven times per year since 1970.¹

Correction Completed?

While some indicators suggest that the equity markets may now be stabilizing, the numbers alone do not tell the whole story. For instance, the major issues that sparked the recent volatility and subsequent correction are still very much with us: the implosion in the value of the euro, a possible credit contagion that could trigger a double-dip global recession, the yet-to-be-determined environmental

impact of the Gulf oil spill, the financial reform legislation and persistent political turmoil in many of the globe's troubled hot spots.

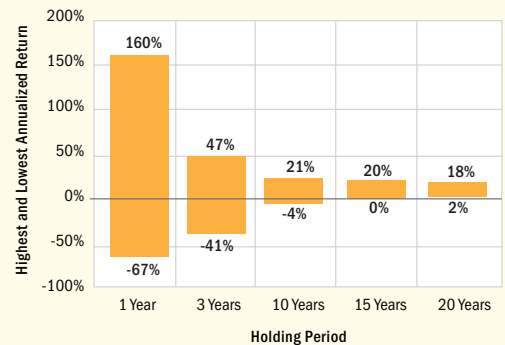
Lessons Learned

Instead of reacting hastily to the market's next twist or turn, try to stay calm and keep the following takeaways in mind.

- **Keep a long-term outlook.** It is all too easy to get caught up in the day-to-day or even week-to-week variations in your portfolio's performance. But this type of behavior can easily lead to bad investment decisions. As

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Highest and Lowest Returns Over Various Holding Periods Since 1926



Source: Standard & Poor's. For all indicated holding periods between January 1, 1926, and December 31, 2009. Domestic stocks are represented by the total annual returns of Standard & Poor's Composite Index of 500 Stocks, an unmanaged index that is generally considered representative of the U.S. stock market. It is not possible to invest directly in an index. Past performance is not a guarantee of future results.

How Health Care Reform May Affect You

The new health care bill, officially known as the Patient Protection and Affordable Care Act of 2010, was signed into law earlier this year. While its impact will take years to be fully realized, most agree it will forever alter the health care landscape in America. Following is a summary of some of the law's key provisions.

Big Changes Are Coming

Some big changes have already been put in place or will take effect later in 2010.

- **A tax credit for small businesses.** This year and through 2013, qualifying employers with 25 or fewer employees may receive a credit of up to 35% of their contributions to employee health insurance premiums.¹
- **A rebate for Medicare recipients.** The millions of Americans affected by the Medicare Part D prescription drug “donut hole” will receive a \$250 rebate this year. Starting in 2011, those affected will receive a 50% discount on prescription drugs. By 2020, the donut hole is expected to be eliminated.²
- **Coverage for children.** Insurance companies will be prohibited from denying coverage to minor children with pre-existing medical conditions, and dependent coverage will be extended for young adults (through age 26) via their parents' insurance plan.
- **Coverage for adults.** Insurance companies will be prohibited from imposing lifetime limits on coverage and from denying coverage or cancelling policies if the policyholder becomes ill. In addition,

high-risk pools are being established for individuals who have been uninsurable due to pre-existing medical conditions.

Other significant provisions, such as mandatory insurance coverage for most Americans; expanded Medicaid and federal subsidies for lower- to middle-income families; and state-run insurance exchanges, where individuals and small-business owners can obtain more competitive rates on health insurance, are scheduled to be phased in by 2014.

Takeaways for Consumers and Investors

The new health care law is arguably the most comprehensive piece of legislation to come out of Washington in decades, and it will no doubt evolve over time. Try to stay on top of the provisions that pertain directly to you, keeping the following issues in mind.

Prepare for new taxes — One way Uncle Sam plans to pay the \$940 billion tab for health care is to raise taxes on higher-earning households. For example, starting in 2013, individual taxpayers earning more than \$200,000 per year and married couples (who file jointly) earning more than \$250,000 will pay an extra 0.9% in Medicare payroll taxes.



Also in 2013, a new 3.8% Medicare surtax on investment income will go into effect. For the purposes of the new tax, investment income includes — but is not limited to — interest, dividends and capital gains. The tax applies to the lesser of (a) net investment income or (b) modified adjusted gross income that exceeds the threshold amounts mentioned above.¹

If you believe you may be affected by the coming wave of tax hikes, take time now to review your situation with a trusted tax and/or financial professional and ask about potential tax-planning strategies.

Be open to new investment opportunities —

With the uncertainty surrounding health care reform lifted, investors can focus on the potential impact it may have on various industries within the Health Care sector. Toward that end, S&P Equity Research sees health care reform as positive for the managed care industry, generic drug manufacturers, biotechnology, hospitals and clinics.³

¹Source: *CCH Tax Briefing*, “Special Report: Health Care Reform Act,” March 30, 2010.

²Source: *The New York Times*, “For Consumers, Clarity on Health Care Changes,” March 21, 2010.

³Investments in specialized industry sectors have additional risks, which are outlined in the prospectus.

Higher Taxes Ahead?

Consider an Investment in Municipal Bonds

In case you were not aware, a variety of tax hikes are heading your way in the next few years — that is, unless Congress takes action to alter current tax rules. Here is a rundown on what to expect and why these impending changes make a compelling case for the tax benefits of municipal bonds.

Tax Hikes on Deck

A slew of tax cuts imposed during the Bush Administration are scheduled to expire at the end of 2010. Among them:

- **Income taxes** — Current federal income tax rates on ordinary income range from 10% to 35%, depending on income level and filing status. These rates are scheduled to revert to pre-2001 levels, which ranged from 15% to 39.6%.
- **Capital gains and dividends** — The top tax rate on long-term capital gains is scheduled to increase to 20% from the current 15%, while dividend income, which is currently taxed at 15%, will once again be taxed at the ordinary income tax rate, which could be as high as 39.6%.

Further, as part of the strategy to pay for new health care reforms, the government plans to raise certain taxes on upper-income Americans. (See article on page 2 for more information.)

The Municipal Bond Advantage

No one can predict whether these tax changes will come to fruition as currently scheduled. However, given mounting federal deficits and the prevailing political winds from Washington, many expect tax rates to increase — making municipal bonds more attractive than ever.

Municipal bonds, or “munis,” are bonds that are issued by state or local municipalities to help finance public projects such as road and school construction. Generally, the interest earned on municipal bonds is exempt from federal taxes and sometimes state and local taxes.¹ Although municipal bonds generally pay lower yields than taxable bonds, they also have the potential to deliver higher returns than taxable bonds on an after-tax basis (see chart). The tax-exempt component of munis makes them valuable to investors in higher tax brackets — even more so at a time when tax increases are all but certain to occur.

There is another, unrelated tax development with regard to munis: Tucked inside the 2009 stimulus legislation is a



The Tax-Exempt Advantage

If your tax-exempt yield is ...	And you are in the following federal tax bracket ...			
	25%	28%	33%	35%
Here is what you would need to earn from a taxable investment to match the tax-exempt yield:				
3%	4.00%	4.17%	4.48%	4.62%
4%	5.33%	5.56%	5.97%	6.15%
5%	6.67%	6.94%	7.46%	7.69%
6%	8.00%	8.33%	8.96%	9.23%
7%	9.33%	9.72%	10.45%	10.77%

For illustrative purposes only. Rates apply to ordinary income, not capital gains. This example does not take into consideration state or local taxes or rates under the alternative minimum tax, nor is it meant to predict any future tax rates.

provision that exempts private activity municipal bonds issued in 2009 or 2010 from the alternative minimum tax. This provision further enhances the tax savings available to higher-income investors.

¹Municipal bonds are subject to availability and change in price. They are also subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Municipal bonds are federally tax free, but other state and local taxes may apply. Any capital gains are taxable for federal and, in most cases, state purposes. In addition, some municipal bonds may be subject to the federal alternative minimum tax. Please consult your tax advisor before making any tax-related investment decisions.



High-Net-Worth Investors Favor IRAs Over Workplace Plans

High-net-worth and affluent Americans are funneling monies once earmarked for employer-sponsored retirement plans, such as 401(k)s and 403(b)s, into IRA accounts and to a lesser extent, bank accounts.

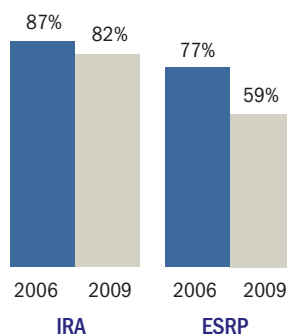
A new report, *2010 Investor Assets in Motion: IRA & Retirement Marketplace Opportunities*, published by Cogent Research LLC, found that while ownership of both types of retirement accounts is down since 2006, IRA ownership has fallen just 5% and ownership of workplace retirement accounts has declined by 18%.

This shift has resulted in the proportion of assets affluent Americans hold in IRAs (31%) surpassing the proportion of assets they hold in 401(k)s and other employer-sponsored accounts (25%).

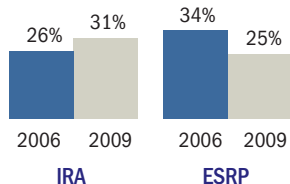
Commenting on the trend, Cogent Senior Research Director and author of the study, Meredith Lloyd Rice stated, “The good news is that while many Americans are losing access to 401(k) plans as a result of job separation or simply choosing to retire, they are making smart decisions regarding where to move their money — namely putting it in an IRA.”

And it appears that the rollover momentum shows no signs of slowing down. While fewer investors may have assets sitting in former employer retirement plans (24% in 2009 vs. 31% in 2008), those who do are even more likely to roll over those assets into an IRA (45% in 2009 vs. 39% in 2008).

Overall account ownership



Proportion of total assets held in IRAs and ESRPs



the chart on page 1 shows, the longer you hold an equity investment, the less likely you will be to experience high variability of returns. For all one-year periods since 1926, stock returns, as measured by the S&P 500, have varied from as low as -67% to as high as 160%. For all 10-year periods, returns have not been below -4% or higher than 21%. And for periods of 15 years or more, returns have all been positive; of course, past performance cannot guarantee future results.³

- **Take advantage of asset allocation.** Does your portfolio’s asset allocation — your mix of stocks, bonds and cash equivalents — accurately reflect your needs? During volatile times, more risky assets such as stocks tend to fluctuate more, while lower-risk assets such as bonds or cash may be more stable. By allocating your investments among these different asset classes, you may be able to smooth out the market’s short-term ups and downs; however, past performance cannot guarantee future results.
- **Consider buying opportunities.** Although many investors may be rightfully gun shy in the wake of the market turmoil of 2008, one strategy you may want to consider is selectively adding to your portfolio. This is especially true when prices are low versus historical averages. A systematic purchasing plan, also known as dollar cost averaging, can help in volatile times, as it provides for regular purchases over a period of time, taking the guesswork out of specific timing of purchases.

¹Source: Standard & Poor’s, *The Outlook*, May 26, 2010. Investing in stocks involves risks, including loss of principal.

²Source: Standard & Poor’s, *The Outlook*, June 23, 2010.

³Source: Standard & Poor’s. For all indicated holding periods between January 1, 1926, and December 31, 2009. Domestic stocks are represented by the total annual returns of Standard & Poor’s Composite Index of 500 Stocks, an unmanaged index that is generally considered representative of the U.S. stock market. It is not possible to invest directly in an index. Past performance is not a guarantee of future results.