

INVESTMENT UPDATE

THE MUNCY BANK & TRUST COMPANY

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It really is darkest before the dawn during recessions. **3**

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Active mutual funds once again fail the skills test. **4**

Points of interest:

- The average stable value fund returned 4 percent last year.
- About 80 percent of transfers within 401k accounts during 2008 went into stable value funds.
- Stable value funds held \$520 billion in assets at the end of 2008.
- AIG insures 10 percent of stable value assets.

INVESTORS FLOCK TO STABLE VALUE FUNDS, DESPITE THEIR RISKS

Last year's stock market turmoil sent a lot of 401k investors running for cover. The most popular investment options for those who pulled money from the stock market were stable value funds, according to industry sources.

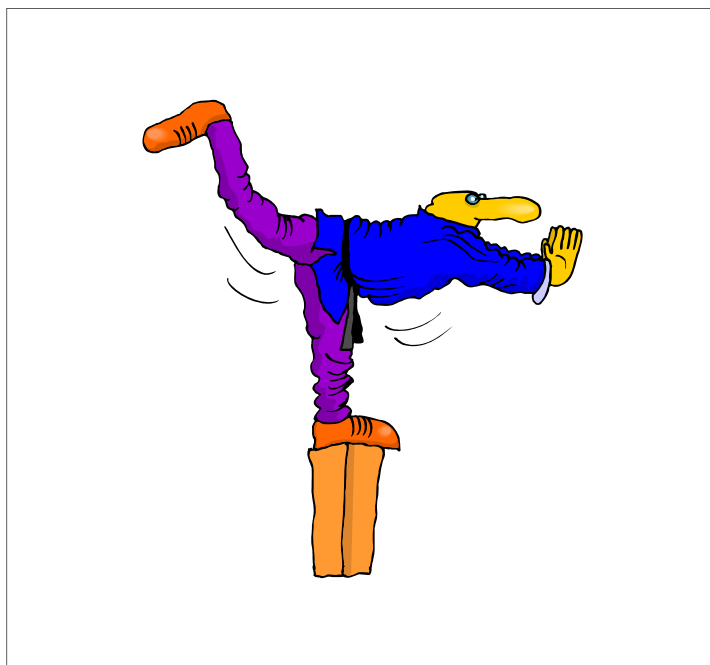
Also known as capital preservation funds or fixed-interest funds, these funds promise to pay a fixed interest rate without fluctuation in share price.

Most stable value funds delivered average returns of about 4 percent last year, making them far and away the top performing choices in many 401k plans. Workers responded by boosting assets in these funds by 25 percent in 2008.

However, retirement savers shouldn't be lulled into a false sense of security. In order to deliver such interest rates—which were above market interest rates on short-term investments—stable value funds have to take bond market risks. And the insurance contracts that guarantee share price stability are themselves subject to risk.

Safety in... AIG?
Should investors feel safe in stable value funds knowing that 10 percent of their holdings nationwide are insured by American International Group, the failed insurance giant that is struggling to survive on the government dole?

AIG's involvement in this



Massive fluctuations in bond prices and failures of insurance companies are making it harder for stable value funds to maintain their balance.

market is one of several reasons the government continues to prop up the insurer, Federal Reserve Bank Chairman Ben Bernanke told Congress in late March.

"Workers whose 401k plans had purchased \$40 billion of insurance from AIG against the risk that their stable value funds would decline in value would have seen that insurance disappear," Bernanke testified.

How they work

Stable value funds invest in diversified bond portfolios in order to generate the interest they pay to investors. They attempt to avoid the daily

fluctuations in bond prices by backing their holdings with insurance contracts that protect against market swings.

This strategy has generally worked well over the years, but when markets are in turmoil and insurers are hurting stable value funds can end up declining in value and can even become insolvent.

That's just what happened to one fund, the Trust Advisors Stable Value Plus, back in 2005. It held investments from 1,500 retirement savings plans when excessive risks in its holdings caused it to fail. Investors had to wait

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WITHDRAWALS AT FAILED COMPANIES HURT STABLE VALUE FUND PRICES

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more than a year to recover their money from the fund.

Chrysler workers who invested in the firms' Stable Value Fund B were shocked when the fund went belly up earlier this year. They received only 89 cents on the dollar as reimbursement.

The failure was caused by a rush to the exits by Chrysler workers who lost their jobs. The massive withdrawals meant that the fund had no time to make up for

recent market declines.

Indeed, industry experts say that company failures pose the biggest risk to stable value investors.

One expert, David Merkel, chief economist at Finacorp Securities, says he "won't be surprised" to see a stable value fund fail this year.

The Stable Value Investment Association, an industry trade group, says the funds continue to pose low risk and that it takes "a perfect storm" to cause a failure.



Fleeing investors hurt stable value funds.

However, the failure of major financial institutions and continued credit market problems have posed just such a storm, experts say.

SHOULD YOU AIM FOR A BIG TAX REFUND?

Taxpayers have filed their 1040 forms (or asked for extra time to file) for the 2008 tax season and are now sitting back and waiting for refunds.

Traditional advice has advocated that a big refund is bad, because it means that an investor paid too much in withholding or estimated taxes and gave the government a tax-free loan.

Instead, taxpayers have been told to adjust their withholding so that they pay in just enough to cover their taxes, allowing them to invest the rest of their money and earn extra interest.

Behavioral economists have begun to question this convention as they gain insight into how individuals use large amounts of money.

Save or spend?

Studies have shown that Americans tend to find it hard to save when they receive income periodically. A few dollars more a week in a paycheck is more likely to get spent than saved.

But when income comes in larger lump sums, it seems more significant and is more likely to be saved.

One study showed that workers who got part of their income in annual bonuses tended to save more money than those who got all of their pay weekly.

Also, the argument that someone who gets a big refund is giving up significant investment earnings is pretty weak in an era of low interest rates.

Suppose you have a savings account that yields 2 percent, which would even be a high yield in today's market. Instead of having the average federal tax refund of about \$2,500 withheld from your paycheck, you choose to take

an extra \$208 in monthly income. Each month that money goes right to your savings account.

Trivial earnings

The interest earned over the 12 month period amounts to a trivial \$19.

So don't feel bad about getting a refund, as long as you are determined to put a good part of it away.

The first choice should be to add to, or start, an emergency fund. Having several thousand dollars sitting in a certificate of deposit or money market fund can help you avoid borrowing for unexpected expenses.

The second choice is paying off debt, starting with high interest credit cards. If you have a good emergency fund and no debt, put the money away for retirement, preferably in a Roth IRA.



It used to be common wisdom that paying too much tax withholding was bad, but getting a big refund may be a key to building savings.

"But when income comes in larger lump sums, it seems more significant and is more likely to be saved."

JUST WHEN THE ECONOMY IS AT ITS LOW POINT, STOCKS BEGIN RECOVERY

A deep recession coupled with a bear market for stocks usually makes investors more and more pessimistic about the future.

Yet it is often just at that maximum moment of pessimism that the stock market begins to rally. In most cases stocks have produced double-digit returns in the 12 months following the economy's bottom.

A recent study by Mark Riepe, head of the Schwab Center for Financial Research, found that investors profited well after 9 of 10 low points hit during recessions since World War II.

GDP is key

He calculated stock market returns beginning in the calendar quarter when Gross Domestic Product, a measure of all goods and services produced in the United States, hit its lowest point.

The average return for the Standard & Poor's 500 Stocks Index was 22 percent over the next 12 months. The gains ranged from 15 percent

in 1949-50 to 45 percent in 1953-54.

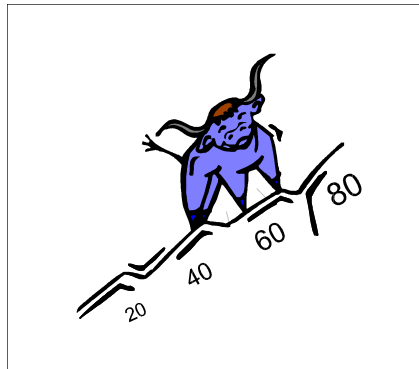
There was one exception: after GDP hit its low point in the last recession during the third quarter of 2001, the market went on to lose 22 percent over the next 12 months as tech stocks continued to suffer.

"It is hard not to be at least a little perturbed by the fact that the one negative result just happens to be the most recent," Riepe said.

Job loss rallies

Another low point in recessions is marked by the point of maximum job loss. Again, Riepe found that in the year following the month with the worst job loss, the market was up by an average of 23 percent.

The exception again came in the last recession. Payrolls hit a trough in Oct. 2001, but the market continued to fall by 16 percent over the next year.



The bull market starts just as the economy hits its lowest recession point.

What's the lesson for investors? Unfortunately, as Riepe notes, no one rings a bell when the economy hits bottom. We are not certain that the bottom has been reached until well after the fact, usually too late to get in on the gains.

That means it is hard to use this information to time when to buy stocks.

Instead investors who want to participate in market recoveries should remain invested throughout a recession, he argues.

"In most cases stocks produced double-digit returns in the 12 months following the economy's bottom."

COMPLEX TAXES, AVOIDING 401KS, & MORE

If you thought doing your income taxes this past season was more confusing than ever, you are not alone.

Nina Olson, the IRS taxpayer advocate, recently told Congress that it now takes the average taxpayer 26 hours and 40 minutes to prepare a 1040 form.

Taxpayers also spend some \$193 billion a year to report their taxes.

Meanwhile, complexity increases: there have been 3,250 changes in the tax

code since 2001, and it has grown to 3.7 million words from 1.4 million back in 2001.

Avoiding 401ks

Workers are avoiding looking at their 401k statements, reports I-Pension LLC. Its survey found that one quarter of middle-income investors refused to look at their fourth quarter 2008 statements.

And 75 percent of those who did open their statements looked at them for less than three minutes.

More than half did not rebalance or make any other changes to their accounts in 2008.

Retirement blues

The recession and stock market downturn has dampened retirement expectations, says the Employee Benefit Research Institute.

Its annual confidence survey found that the number of workers feeling very confident about retirement dropped by half in two years. Recession concerns and worries about meeting medical expenses were widespread.



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ONLY LUCK, NOT SKILL, HELPS SOME ACTIVE FUNDS OUTPERFORM

Stock mutual funds that actively investigate, select, buy, and sell stocks claim to have the skill to outmaneuver the mass of investors.

Yet another detailed study says there may be no truth to those claims. When individual active funds do manage to beat the market for a time, they do so merely by luck rather than skill.

A massive study that ran thousands of simulations of performance of actual stock mutual funds found virtually no evidence that any fund managers beat the market after the funds' cost of investing.

The study was done by famed investment professors Eugene F. Fama of the University of Chicago and Kenneth R. French of Dartmouth College.



Active fund managers claim to have market-beating skills, but where is the evidence?

“The challenge is to distinguish skill from luck,” they wrote. “Given the multitude of funds, many have extreme returns by chance.”

The study covered stock mutual funds in existence between 1984 and 2006. They looked at actual returns and did 10,000 simulations of returns.

“For fund investors the simulation results are dis-

heartening,” they wrote.

Although some fund managers beat the markets on a gross return basis, after the funds' costs they did not.

“Thus, if there are managers with sufficient skill to cover costs, they are hidden among the mass of managers with insufficient skill,” Fama and French said.

They found that only about 2 percent of funds appeared to have the skill to overcome average net investment expense of 1 percent.

What's more, there is no evidence that an investor can identify any of those managers in advance of their market-beating performance.

The bottom line is that passively managed funds that stick to a total market allocation offer assurance of obtaining the market's returns.