FINANCIAL CONNECTIONS
GROUP INCORPORATED

Quarterly Newsletter

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For Clients and Friends of Financial Connections

Remember worrying about Y2K on January 1, 2000, a decade ago? Would the computers around the world be able to make the adjustment from 1999 to 2000? We all kept extra cash at home just in case the ATM didn't work.

The drama that ushered in the decade did not diminish. By December 31, 2009, it had become the worst decade for domestic stocks since the Great Depression. We faced:

- Terrorists attacks around the globe
- 9/11 here at home
- Our troops at war in the Middle East
- Burst housing bubble
- Dot-com fiasco
- Two major bear markets
- A swing from a national surplus to an unprecedented increase in national debt
- A global financial system on the verge of collapse

The S&P 500 for the last ten years lost a total of -9.12% (-0.95% annually). But bonds and international investments were up for the decade.

New Offering for Small Businesses with Employees

If any of your friends or business associates would like to establish a 401(k) retirement plan or review their existing company retirement plan, we are available to help. Please have them call us.

2009 and Beyond

Looking back at the investment experience in 2008 and 2009 might well cause whiplash. Asset classes with negative returns in 2008 were positive in 2009. The only exception: some government bonds were positive both years.

And a glance back at 2008 and 2009 doesn't convey the story of volatility, fear, and anxiety these years held.

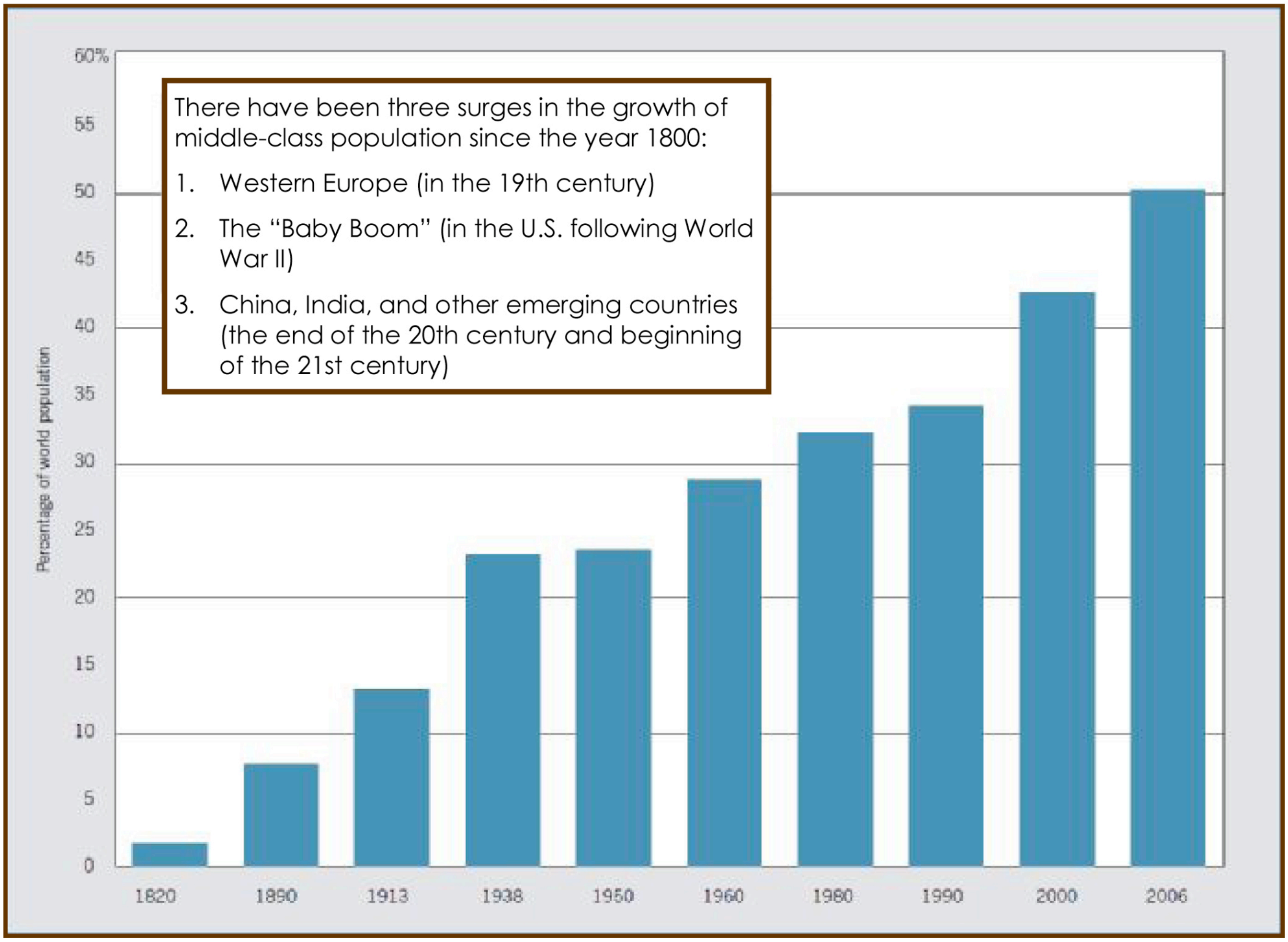
So where do we go from here? There are many questions and conflicting views on the answers.

Will we have a second recession?
When will banks lend again?
When will new jobs be created and how fast?
Where will economic growth come from, once the government stimulus money stops?

Before 2008, global economic growth was spurred by U.S. consumers' overspending. As we Americans pay off debt and live within our means, expansion will come from the new middle classes in China, India, and other developing countries (see enclosed graph). A discussion about developing countries figured in our November 2009 conference call. Let us know if you would like a link to the replay.

Developing countries account for 85% of the world population. The McKinsey Global Institute forecasts that over the next decade 450 million people will be joining the middle class in China and India, buying more goods and services.

- 40% of revenue of the companies in the S&P 500 index originates from outside the U.S., an increase compared to 32% in 2002.
- The industrial sectors of technology and consumer staples earn 50% of their revenues from overseas.
- Companies have an opportunity to sell goods and services to new members of the middle class in the developing/emerging countries.
- More than 60% of the world's stock market value is outside the U.S. And, the same pattern continues in the debt market: Over half of the outstanding debt securities are outside of the U.S.



Sources: American Funds "The Long View" 2009 review/2010 outlook and "Second Among Equals: The Middle Class Kingdoms of India and China," Appendix I for details on construction of real incomes and middle class, Surjit S. Bhalla (2007); Penn world Table 6.1, Maddison (2006); World Bank World Development Indicators (2006); and International Monetary Fund World Economic Outlook (2006). Middle class is defined as the proportion of people whose per capita income is equal to or higher than the weighted average of poverty lines in developed countries. This information herein should not be construed as legal advice or investment advice. Past performance is no guarantee of future results.

We welcome the opportunity to review your current financial situation and investment strategy. Please let us know if you would like to get together.

The following enclosures are included in this package.

- Portfolio Performance Summary for 2009 and since 2000
- Portfolio Position Analysis
- Realized Gains and Loss Report (printed on yellow paper)
  Please give this to your tax preparer (but note: no report is enclosed if Brian and Kim prepare your taxes)

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HOW TO IMPROVE YOUR RETIREMENT OUTLOOK

How much control do you have in determining how you will live in retirement? Many people think of saving some money, and letting the returns on stocks and bonds do the rest.

Yet small changes in your savings can make a large impact on your retirement savings. First, here Pat's example:

Income:	$100,000 annually
Savings rate:	1% of income ($1,000/year)
Years to retirement:	20
Salary increase:	2%/year
Rate of return:	8% (very generous)
Result:	Portfolio is worth $93,741.65 after 20 years

Now consider Chris, in similar circumstances:

Savings rate:	7% of income (same as 2009 consumer savings rate)
Rate of return:	4% (more conservative)
Result:	Portfolio is worth $373,183.84 after 20 years

Granted, you can't expect to earn the same rate of return every year. But what we can say is the savings rate is more important than the return rate. A seemingly small change in savings can add up dramatically over time.

WHAT TO DO WITH THE FINANCIAL SYSTEM

There is no easy fix for the complex global financial system. But we note with concern that "business as usual" is the theme of the day, and that changes currently before Congress to help prevent another crisis seem watered down and full of loopholes.

In the January 11 edition of Business Week, Charlie Rose interviewed Paul Volcker, former Federal Reserve chief whose claim to fame was "conquering inflation." Although Volcker is the chairman of President Obama's Economic Advisory Board, his views do not figure in the current approach to fixing the financial system.

Volcker's remedy (in brief) is to focus on the system's core:

> "The kind of reform I've been advocating is acceptance of the fact that the core of the system remains commercial banking. If that breaks down then you have an enormous crisis. And commercial banks have expanded into areas I don't think are so central. I would cut back their so-called capital market activities—hedge funds, equity funds, commodities trading, trading in derivatives….I don't want to protect everybody because when people act like they're protected, you get in trouble. So let's leave the capital market to their own devices without any expectation of government protection and keep the existing safety net for the commercial banking system."

In our last newsletter, we discussed the "Too-Big-To-Fail" concept and arguments against government protectionism by several economists from the University of Chicago and Thomas Hoenig, president of the Kansas City, Missouri Federal Reserve Bank.

Without presuming to have the knowledge of these professionals, we agree with Volcker's position on the Too-Big-To Fail environment. We only wish Washington DC would talk more with Main Street instead of the lobbyists.

INCREASE IN SAVINGS RATE

The savings rate for most of the last decade was 0% but rose to almost 7% in 2009. Some observers worry that unless consumers start to spend more, the economy will continue its pattern of slow growth.

While that may be true, we don't know any financial advisor who doesn't applaud consumers for saving more (See HOW TO IMPROVE YOUR RETIREMENT OUTLOOK). Saving is a positive long-term trend and the economy will adjust. Over the decades before the savings rate dropped to 0%, consumers saved almost 10% and our economy grew.

Paying off debts, saving more, and living within our means lacks glamour and may be difficult in the short term. But think of the positive effects on the long-term future of the economy!

Please check with your tax preparer:
The fee you pay to Financial Connections may be tax deductible. The total amount for the calendar year is on the first page of the enclosed Portfolio Performance Summary report. (Does not apply to retirement accounts.)

INFLATION IN 2009

The Consumer Price Index (CPI) rose 2.7% in 2009 compared to 0.1% for 2008.

The energy index rose 18.2%, after falling 21.3% in 2008. The majority of the rise came from the gasoline index, which rose 53.5% in 2009. In contrast, natural gas fell 18.1%.

CONVERTING YOUR IRA WITH TAXABLE DISTRIBUTIONS TO A ROTH IRA WITH TAX FREE DISTRIBUTIONS

Previously, only taxpayers with modified adjusted gross income of $100,000 (single or married filing jointly) were permitted to convert a traditional IRA to a Roth IRA. Beginning this year, there is no income limitation.

As a special incentive only for Roth conversions that occur in 2010, the taxable amount on the conversion can be paid over two tax years (2011 and 2012). Or, you can pay the taxes in tax year 2010 if you anticipate tax brackets to increase in 2011 and 2012.

What to do? Many taxpayers who are unable to make deductible contributions to their IRAs are thus making non-deductible contributions today with an eye toward converting their IRA to a Roth.

Whether it is a good financial decision to convert all or some of your IRA to Roth, depends on such factors as age, whether taxes can be paid from non-retirement funds, anticipated income in retirement, etc.

If you'd like to discuss whether this is an opportunity for you, please give us a call.