

September 2, 2008

TO: All clients and interested parties

FROM: Bob Kargenian

This quarter, we take a look at the question, “Should you take a lump sum payment from your pension plan?” Also, you’ll hear our view on why we think its important to have “skin in the game.” We’ll also look at the seven common traits from those who build wealth successfully, along with a look at second quarter performance.

In addition, for the benefit of our clients who do not use the Internet (about 25%), we’ve enclosed a reprint of an article we penned in late July called Maximum Stress. It emphasizes the perils of inappropriate investor behavior along with an optimistic outlook three to five years out (at least in relation to cash).

Your Company Pension Lump Sum—Should You Take It?

Though 401(k) plans have become more popular since the early 1980s (also known as defined contribution plans), there are still 30 million Americans who are covered by a traditional defined benefit pension plan, and they’ll be faced with a crucial and irrevocable decision when they retire.

These plans promise a lifetime monthly retirement income (also known as an annuity), and most come with an option to continue the income to a surviving spouse after you die. Many, but not all plans, also provide an option of a one-time lump sum, in lieu of the annuity. When faced with such an option, the obvious question is—which should you take?

We’ve been asked that question many times over the years. As an example, our diverse client base has spawned retirees from the likes of General Motors, The Tribune Companies, Stater Brothers, the University of California and the State Teachers Retirement System (STIRS) and Public Employees Retirement System (PERS).

The short answer is—it is not black and white, and there is not really a right and wrong choice (except in hindsight). As I’ll attempt to summarize here, it all depends on the individual situation and what the priorities are of that individual or couple. According to the Society of Actuaries, the vast majority of retirees—90%, choose the lump sum.

Let’s start with the assumption that when you retire, you’ll want to generate a retirement income that will last the rest of your life, no matter what happens to the economy or the financial markets. When the decision is thought of this way, it introduces some variables that a lot of people don’t understand. Many underestimate how long they will live, or

they don't have a disciplined, systematic way of drawing down their capital so they'll not outlive their money.

A pension benefit (aka annuity) is much like Social Security—at a certain age, you are promised a monthly benefit for the rest of your life. Some pensions are indexed for inflation like Social Security, but many are not. For an example, let's say you are 65, retired and eligible to receive \$2000 per month, and for the sake of simplicity, let's say that amount is your 100% joint survivor benefit.

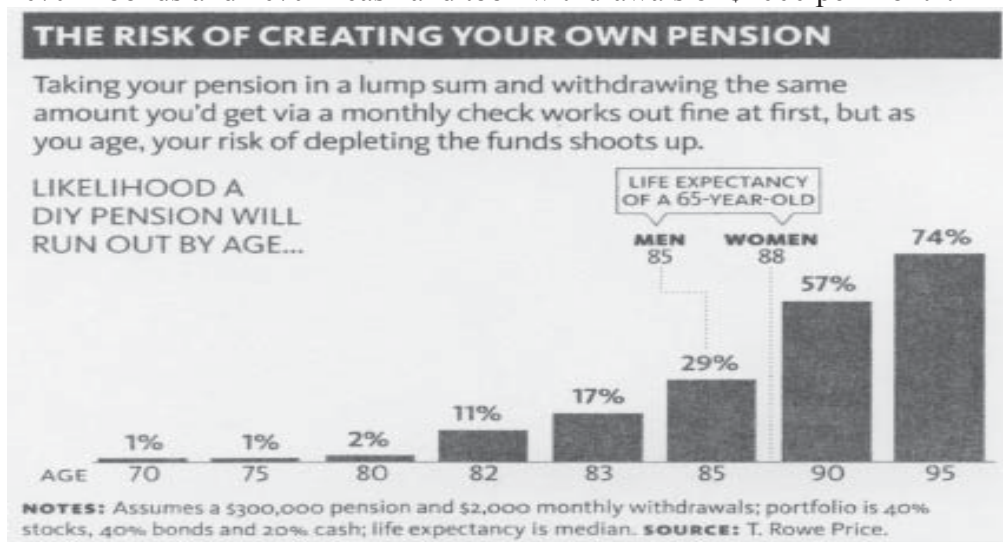
That means if you die, your spouse will continue receiving 100% of your benefit, or \$2000 per month until they die, at which point everything stops. In this example, a 75% joint survivor benefit would decline to \$1500 per month after the death of the pensioner. But actually, for the sake of brevity here, if one were to choose a 75% option or 50% option, the pensioner would receive a greater amount while living in comparison to the 100% option.

In the example we are using, instead of \$2000 per month, the retiree is also offered a lump sum of \$300,000. When framed this way, the factors become more finite—how long will you (and perhaps your spouse) live, and how well can the money be invested?

This is where the fork in the road can be different for many. Unfortunately, none of us know how long we may live, but individual health histories can be considered. It is intuitive that if you weren't going to live very long, taking the lump sum would be a better choice, since what is left when you are gone is passed on to your heirs through an IRA rollover.

Likewise, if you knew you were going to live a long time, the monthly guarantee would likely be the better choice. Consider that a 65-year-old man has about a 50% chance of living to age 85, while a woman has about a 50% probability of getting to age 88.

According to an analysis by T. Rowe Price (see accompanying graph), there is nearly a 30% chance of depleting a \$300,000 lump sum by age 85, assuming you invested 40% in stocks, 40% in bonds and 20% in cash and took withdrawals of \$2000 per month.



As I mentioned earlier, a number of factors come into play that aren't just apparent from the numbers. It has been noted in several retirement income studies that if one uses a 5% withdrawal rate in retirement, there is a very high probability of maintaining one's principal over a 30-year time period. In our example above, if you were to take 5% of \$300,000, that equates to \$15,000 annually, or \$1250 per month. That's 37% less than the \$2000 monthly guarantee from the pension.

If you were strictly looking at this and nothing else, you'd have to earn 8% on the lump sum to equate to the \$2000 guarantee, and that is not a great bet. But the point is, there is usually something else to look at. Many retirees have IRA accounts and other taxable savings that will supplement their retirement income, and that can make up the \$750 monthly shortfall in our example.

For many, they like the flexibility of being able to leave additional sums to their heirs, an option that is not possible with an annuity. The downside is if the money is managed poorly, one can run out of money prematurely. One of the other big risks is that the retiree does not have the discipline to stick with the plan, and because the MONEY IS THERE, they begin to withdraw sums far in excess of a sustainable rate. Soon, much of the money is gone. Unfortunately, we've seen this happen with several retired clients, but I'm sad to say it's also happened with clients still in their 50s, who have been tapping their IRA's for needs (or wants) other than that of retirement.

I'm sure many of you have read stories about lottery winners, and how several years later many of them have little or nothing left. That's because they took the lump sum and then pissed the money away (sorry—"spent" doesn't get my point across). No plan, no discipline and in many cases, no financial literacy. This is also why, in my view, privatizing Social Security would only work if there were strict, no-touch rules and the money was managed by independent, third-party fiduciaries. I'm not saying the government is better—I'm saying the large majority of people cannot effectively manage their own retirement funds.

All in all, we've found the best combination for those clients blessed with these options is when they have sufficient liquid assets in IRA's and taxable savings to complement a monthly pension. This combination gives one peace of mind that a good portion of their retirement income is guaranteed, yet there is ample liquidity to do some of the things one wants to do in retirement, and still leave a legacy to their heirs without being totally worried that everything is dependent on the stock and bond markets.

The latter point should not be overlooked. Other than Social Security, if one's retirement income is coming purely from savings in a diversified portfolio, it can be difficult for some to deal with the real life ups and downs of investing cycles. It is one of the reasons we put such an emphasis on risk management in an attempt to minimize downside volatility.

Skin In The Game

What would you think of a chief executive who didn't own stock in his company? In my view, that would indicate a lack of conviction, a lack of belief, and would be a huge warning sign.

Yet, a new report from Morningstar Inc. looks at fund managers' personal stakes in the funds they run, and concludes: "The number of managers showing no faith in their process is staggering."

Specifically, the report, which analyzed nearly 6,000 stock and bond funds, found that 47% of U.S. stock funds had no manager ownership. This figure jumped to 61% for foreign stock funds and 71% for balanced funds.

For the record, virtually all of the liquid net worth of the principals and staff at TABR is invested right alongside our clients, in the exact same funds and strategies, and it has been that way for as long as I can remember (back to my Prudential/Wachovia days). I can't take credit for the idea—Dan Sullivan of the Chartist newsletter in Seal Beach, CA has been maintaining an actual cash account since the 1980s. I totally agree with Sullivan's posture that any investment advisor worth his salt should be invested alongside their clients—after all, if its good enough for them, it should be good enough for you (the advisor).

I believe transparency and a vested interest are important traits in our business, and we've built TABR on that premise. Many clients have privately expressed their frustration with the housing crisis, caused by irresponsible lending and irresponsible borrowing by many who simply didn't belong owning a home. That is what happens with zero or low money down loans, or interest-only loans or those with negative amortization. There's no skin in the game. There's no incentive.

I rented an apartment until I was 30 years old—until I had saved 20% for a down payment on a 1600 square foot house in Placentia selling new for \$167,000. In 1994, when our son Adam was born, we put down 64% on a bigger home, and in 2005 when we recently moved, we put down 70% (can you tell I don't like debt?). Many of us are blessed beyond belief, but it is still a truth that not everyone has the right to be a homeowner anymore than everyone has the right to drive a Lexus.

Bottom line, when it comes to investing clients money, its not enough to talk the talk. You need to walk the walk.

The Seven Factors To Building Wealth

"The Millionaire Next Door," was written in 1996 by Thomas T. Stanley and William D. Danko, and its findings are as relevant today as then, so here goes. First, *eighty percent of America's millionaires are first-generation rich.*

As they wrote over a decade ago, "Affluent people typically follow a lifestyle conducive to accumulating money. In the course of our investigations, we discovered seven common denominators among those who successfully build wealth."

1. They live well below their means.
2. They allocate their time, energy, and money efficiently, in ways conducive to building wealth.
3. They believe that financial independence is more important than displaying high social status.
4. Their parents did not provide economic outpatient care.
5. Their adult children are economically self-sufficient.
6. They are proficient in targeting market opportunities.
7. They chose the right occupation.

As Alexander Green, the Investment Director of the Oxford Club noted in his November 26, 2007 commentary, “Wealth is not the same thing as income. If you earn a lot of money and blow it every year, you’re not getting rich. You’re just living high. Wealth is what you accumulate, not what you spend.”

Second Quarter Performance

Below is the performance, net of management fees, of six real-time portfolios we are tracking. These represent a majority of the strategies we are using in client accounts, but not all. The differences are mainly attributed to risk (example—moderate allocation versus conservative allocation or aggressive) and account size. The numbers are for the first six months of 2008, through June 30.

Type of Account/Strategy	YTD	Benchmark
TABR Moderate Risk Account	+0.20%	-6.12%*
TABR Stock Wrap Account	-8.65%	-10.91%**
TABR OEX Relative Strength	-12.75%	-14.24%(S&P 100)
TABR D.A.L.I. Account	-3.15%	-6.12%*
TABR Passive Allocation	-7.46%	-6.12%*
TABR Bond Account	-0.48%	+1.07%***
Vanguard Total Stock Index		- 10.91%
Vanguard Total International Stock Index		-10.91%
Vanguard Total Bond Index		+ 1.07%

*consists of 45% Vanguard Total Stock Index, 15% Vanguard Total International Stock Index and 40% Vanguard Total Bond Index

**Vanguard Total Stock Index

***Vanguard Total Bond Index

Returns shown are net of management fees, and include reinvested dividends

The approximate average invested exposure of our tactical equity allocations for the first six months of 2008 was 49%. As this is being written in early September, exposure has been flipping from 50% to 75% the past several weeks, as uncharacteristically, one of our stock market risk models has changed modes three times in three weeks.

As we’ve individually communicated to the approximate 45 clients who have participated in our stock wrap program since 2004, we decided to terminate this program in early July after some long deliberations, rather than wait until year-end. There were a variety of reasons, but most notably, it came down to the performance not living up to our

expectations, greater than average volatility, and the rewards simply not being in line with the efforts put forth.

We've actually found that over time, our simplest work has been more effective than the complex work. We've also discontinued the OEX Relative Strength portfolio listed above. It was never used with client capital, and though quite simple in its execution, involved quite a bit of turnover. Hey—perhaps we're not cut out for picking individual stocks. I don't have a problem with that, since our mutual fund work has served us (and clients) pretty well since 1988.

It is certainly debatable if we've given the stock screens enough time to perform, since two of the three have only been in use less than two full years. As a result, I've kept my own account trading the strategies going for now, but on a reduced dollar basis. By year-end, you'll see the creation of a real-time TABR Conservative Risk Account, which will mimic what we do for clients in that risk tolerance category.

Fall is pretty much here. School has started around the country (our 3 ½ year old princess, Caroline, starts pre-school), pro and college football are back, the baseball playoffs are around the corner, and history is in the making in politics, with our first ever African-American Presidential nominee and first ever woman as a Republican vice presidential nominee. Whomever you favor, our duty is to at least vote. And remember—though the American economy is most likely in a recession now—it will do just fine. But it won't do fine every year and every week and every month.

Best regards,



Bob Kargenian, CMT
President

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The TABR Model Portfolios are allocated in a range of investments according to TABR's proprietary investment strategies. TABR's proprietary investment strategies are allocated amongst individual stocks, bonds, mutual funds, gold and other instruments with a view towards income and/or capital appreciation depending on the specific allocation employed by each Model Portfolio. TABR tracks the performance of each Model Portfolio in an actual account that is charged TABR's investment management fees in the exact manner as would an actual client account. Therefore the performance show is net of TABR's investment management fees.

Comparison of the TABR Model Portfolios to the Vanguard Total Stock Index Fund, the Vanguard Total International Stock Fund and the Vanguard Total Bond Index Fund is for illustrative purposes only and the

volatility of the indices used for comparison may be materially different from the volatility of the TABR Model Portfolios due to varying degrees of diversification and/or other factors.

Past performance of the TABR Model Portfolios may not be indicative of future results and the performance of a specific individual client account may vary substantially from the composite results above in part because client accounts may be allocated among several portfolios. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable.

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Maximum Stress—Is It Time To Sell?

Not if you believe in probabilities and can look beyond next month's Fidelity statement

By Bob Kargenian

There is a big difference between investment returns and investor returns. The key findings in Dalbar's Quantitative Analysis of Investor Behavior (QAIB), first published in 1994, suggest that investor behavior is the main determinant of investor returns. For the most part, investor returns have lagged investment returns during the past 20 years by a wide margin—over 700 basis points per year, according to Dalbar.

I was reminded of this a few weeks ago, when major stock indexes finally fell more than 20% from their October 2007 peak. This was accompanied by SEC Commissioner Christopher Cox announcing that his agency was going to actually enforce “already on the books” naked short selling rules, and the FDIC takeover of IndyMac Bank in Pasadena, CA.

Imagine picking up your copy of the *Los Angeles Times* on Monday, July 14 and Tuesday July 15. On Monday, the front page headlines blared “IndyMac Bank Fails” followed by Tuesday's over-sized picture of about 150 customers lined up for hours outside bank doors, waiting to extract their deposits.

No doubt, investors nationwide were calling their investment advisors, wondering about the return *of their money*, not the *return on their money*. And just as this was happening, as it has happened many times prior, the market bottomed—at its maximum stress point.

This time wasn't different, because it's never different. Investors repeatedly make the same mistakes, over and over again. What accounts for the mistakes? Simply put, it is relying on one's emotions instead of the data. Chasing strong investment performance seems to be a permanent feature of investor decision making, whether it was technology stocks in the late 1990's or the most recent burst bubble, real estate. Current candidates include international equities and oil/energy stocks/commodities.

On the flip side, excessive emphasis on near-term returns, especially when they are negative, almost surely leads to bad choices. The reason investors do so poorly on their own is because they make emotional decisions at the wrong time—because they have no plan. Despite the fact that market downturns are a fact of life, bear markets test the patience and forbearance of investors. People will tell you they don't mind volatility—as long as it's up, but the bottom line is, people just don't like losing money

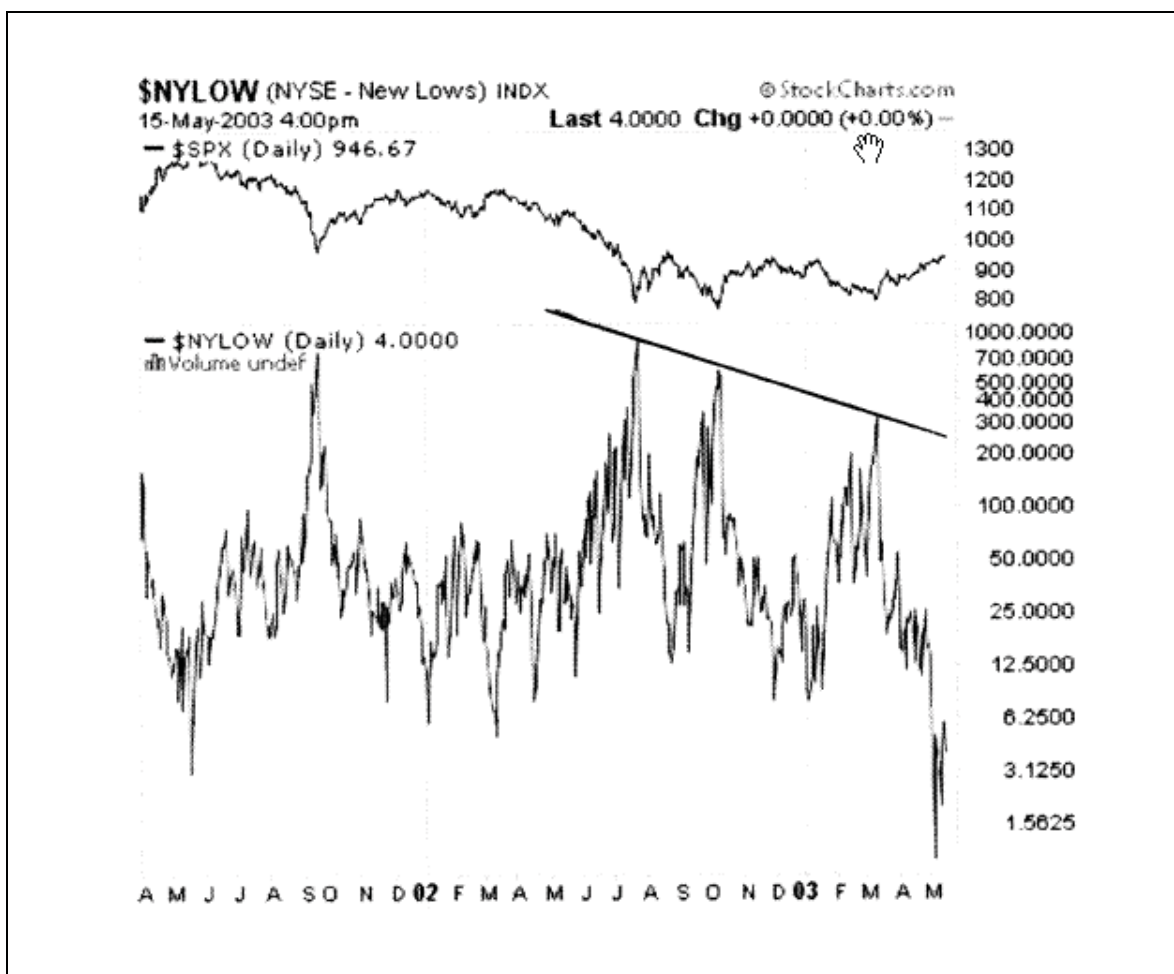
A Bottom, But Not Likely THE Bottom

Since the July 15 low in the S&P 500 at 1214.91, that index has rallied over 7% in just four weeks. Advisory sentiment indicators from both Ned Davis Research and the weekly AAI survey are in position to support at least a trading rally, as are a number of technical studies, including breadth.

The NYSE High/Low indicator, a 10-day moving average of daily highs divided by highs+lows recently moved below 10% and reversed upward for only the 16th time since 1980 (according to Dorsey Wright Money Management). The accompanying table shows the average gain in the S&P 500 3 months after each reversal has been 4.4%, with gains over 8% six months out and nearly 17% on average 1 year later, though the last signal in August 2007 will almost certainly show losses across all three time periods.

NYSE High Low Moves Below 10% with Subsequent Reversal							
Indexed to S&P 500							
Reversal	Value	3 mo later	6 mo later	1 yr later	3 mo gain	6 mo gain	1 yr gain
4/10/1980	104.08	116.95	130.29	134.51	0.123655	0.251826	0.292371
10/7/1981	121.31	118.93	115.46	128.8	-0.01962	-0.04822	0.061743
6/24/1982	109.83	123.32	139.72	170.4	0.122826	0.272148	0.551489
2/28/1984	156.82	150.29	167.4	181.18	-0.04164	0.067466	0.155337
6/11/1984	153.06	164.45	163.07	189.04	0.074415	0.065399	0.235071
8/2/1984	157.99	167.42	178.63	191.48	0.059687	0.130641	0.211975
1/4/1988	255.94	256.09	271.78	279.43	0.000586	0.06189	0.091779
2/7/1990	333.75	340.53	334.83	356.52	0.020315	0.003236	0.068225
5/7/1990	340.53	334.83	306.01	377.32	-0.01674	-0.10137	0.108037
9/18/1990	318.6	330.05	372.11	386.94	0.035938	0.167954	0.214501
12/21/1994	459.61	495.07	543.98	610.49	0.077152	0.183569	0.328278
9/23/1998	1066.09	1228.54	1262.14	1280.41	0.152379	0.183896	0.201034
10/29/1999	1362.93	1360.16	1452.43	1379.58	-0.00203	0.065667	0.012216
8/5/2002	834.6	915.39	843.59	965.46	0.096801	0.010772	0.156794
8/23/2007	1462.5	1440.7	1353.11	1277	-0.01491	-0.0748	-0.12684
7/22/2008	1277	n/a	n/a	n/a	n/a	n/a	n/a
				Average	0.044588	0.082671	0.170801
*thru 7-22-08							

Ned Davis has often pointed out that sometimes, market breadth is “so bad, it’s good.” That seems to be the case recently, when daily new lows on the NYSE reached 1304, eclipsing the 1114 from the January low. That resets the clock though, as most market bottoms occur with a lessening of downside momentum, with fewer and fewer stocks making new lows when the major indexes make their final lows. You can see this example of a positive divergence during the 2000-2002 bear market (see chart), with daily new lows contracting at the final lows in October 2002 and March 2003.



For this reason, the odds do not favor the July 15 low as being the final low of this bear market. That will likely come several months down the road, or possibly even into early 2009, with the S&P 500 potentially reaching into the 1125-1175 zone.

Still, Good Odds Ahead

Knowing that many investors have to be wondering (because they have no plan) what to do now that most stock indexes have entered Wall Street's definition of bear market territory, I asked the Ned Davis Research Group to do a study of all declines of at least 20% in the S&P 500 from 1929 to the present. The results are shown in the accompanying table.

First, we assumed that an investor hypothetically invested in one of three asset mixes, one day after each decline reached at least 20% from a peak. The three mixes were the S&P 500, a 60% stock/40% bond mix using the S&P 500 Total Return and the Lehman Long Term Government Bond Total Return, and finally, 1 year Treasury Bills. We then computed the returns 1 year later, 3 years later and 5 years later.

Report #: WC25883x01												
Report Created by Ned Davis Research Group												
Performance Once 20% Decline Reached												
Bear Market Start	Bear Market End	Magnitude of Decline	Date S&P 500 Decline Reached 20%	1-Year S&P 500 TR GPA	1-Year Stock/Bond Mix* GPA	1-Year T-Bill TR GPA	3-Year S&P 500 TR GPA	3-Year Stock/Bond Mix* GPA	3-Year T-Bill TR GPA	5-Year S&P 500 TR GPA	5-Year Stock/Bond Mix* GPA	5-Year T-Bill TR GPA
9/7/1929	11/13/1929	-44.7	10/28/1929	-10.3	-2.4	2.8	-24.7	-12.1	1.8	-9.8	-2.2	1.2
4/10/1930	12/16/1930	-44.3	6/16/1930	-30.5	-17.3	1.6	-14.9	-5.3	1.2	-7.0	-0.5	0.8
2/24/1931	6/2/1931	-32.9	4/29/1931	-57.7	-38.1	1.7	-4.3	1.9	0.8	4.7	6.8	0.6
6/27/1931	10/5/1931	-43.1	9/12/1931	-32.0	-15.7	1.6	-4.3	2.0	0.8	12.4	11.5	0.5
11/9/1931	6/1/1932	-61.8	11/28/1931	-22.8	-7.0	1.1	7.7	10.1	0.6	19.6	16.2	0.4
9/7/1932	2/27/1933	-40.6	9/14/1932	51.3	34.8	0.5	21.3	16.3	0.3	19.3	14.3	0.3
7/18/1933	10/21/1933	-29.8	7/21/1933	-2.1	2.4	0.3	22.8	16.4	0.2	10.4	9.0	0.2
2/6/1934	3/14/1935	-31.8	5/12/1934	9.0	8.6	0.2	23.7	15.9	0.2	8.7	8.1	0.2
3/6/1937	3/31/1938	-54.5	9/7/1937	-9.8	-1.8	0.1	-5.1	0.1	0.1	-4.0	0.2	0.1
11/9/1938	4/8/1939	-26.2	3/31/1939	13.9	10.9	0.0	-4.9	-0.9	0.1	7.8	6.3	0.2
10/25/1939	6/10/1940	-31.9	5/14/1940	-4.1	0.6	0.0	11.6	8.8	0.2	14.0	10.1	0.3
11/9/1940	4/28/1942	-34.5	11/28/1941	10.5	6.8	0.3	19.2	12.2	0.4	16.0	10.9	0.4
5/29/1946	5/17/1947	-28.8	9/9/1946	8.0	6.6	0.4	7.8	6.0	0.8	16.9	10.7	1.0
6/15/1948	6/13/1949	-20.6	6/13/1949	48.7	28.7	1.1	29.4	17.3	1.4	23.4	14.4	1.5
8/2/1956	10/22/1957	-21.6	10/21/1957	36.4	21.6	1.9	14.5	10.1	2.8	10.8	8.1	2.7
12/12/1961	6/26/1962	-28.0	5/28/1962	25.3	15.8	2.9	18.3	11.9	3.4	12.7	8.4	3.9
2/9/1966	10/7/1966	-22.2	8/29/1966	26.9	16.7	4.6	11.4	6.5	5.4	9.1	6.6	5.6
11/29/1968	5/26/1970	-36.1	1/29/1970	17.7	18.1	6.3	14.5	12.5	5.0	1.3	3.9	6.1
1/11/1973	10/3/1974	-48.2	11/27/1973	-25.2	-14.8	8.2	5.8	7.1	6.5	3.9	4.8	6.4
11/28/1980	8/12/1982	-27.1	2/22/1982	39.2	39.6	10.5	22.8	20.7	9.8	25.7	24.5	8.6
8/25/1987	12/4/1987	-33.5	10/19/1987	23.6	20.9	6.5	13.6	13.1	7.6	15.6	14.7	6.5
3/24/2000	9/21/2001	-36.8	3/12/2001	-2.3	-0.2	2.7	-1.1	3.7	1.7	3.0	4.9	2.1
1/4/2002	10/9/2002	-33.8	7/10/2002	9.6	13.3	1.3	11.4	11.1	1.5	12.3	9.9	2.7
10/9/2007	N/A	N/A	7/9/2008	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	MEAN	-35.3		5.4	6.4	2.5	8.5	8.1	2.3	9.9	8.8	2.3
*Stock/Bond Mix = 60% S&P 500 TR & 40% Lehman LT Govt Bond TR												
**Monthly Bond and T-Bill data interpolated prior to 1981 and 1979												
***Holding periods begin 1-day after decline reaches 20%												

In all three time segments, the stock/bond mix, most representative of a prudent investor's portfolio, substantially outperformed Treasury Bills. More reliably, with a minimum three-year time horizon, the stock/bond mix had only three losing periods, two of which began in 1929 and 1930. The third, in 1939, lost just 0.9%.

Going out five years, the only two losing periods for the stock/bond mix also began in 1929 and 1930. The mean return over 23 different occurrences was 8.8% per annum compared to 2.3% for Treasury Bills.

The message is quite clear to me. Unless you think we are in a Depression similar to the early 1930's, the data suggest that a diversified portfolio of equities and fixed income over the next three to five years will likely beat cash, and possibly by a substantial margin. Some disciplined risk management would enhance these odds even further. And quite frankly, if you think we're in a Depression, you probably shouldn't be investing anyway. The U. S. stock market has been through bad times before, and recovered impressively, but buying and hoping is not the answer. Invest with the data, not your emotions.

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