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WATERFORD ADVISORS

An SEC Registered Investment Advisor ■ Certified Financial Planner™

6225 Sheridan Drive ■ Suite 214 ■ Williamsville, NY 14221

To:

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SPRING
2009

WATERFORD ADVISORS

An SEC Registered Investment Advisor

A Quarterly Newsletter for Our Clients, Friends & Associates



Investment Commentary

First Quarter 2009

Stocks saw their best one-month gain in March in more than six years, but while it was a welcome respite from the battering in January and February, the first quarter still ended with a double-digit loss for equities. The large-cap S&P 500 (based on Vanguard 500 Index Fund) surged by almost 9% in March, yet finished the first quarter with an 11% loss. While returns in March did not vary by much across equity styles, that was not the case for the quarter. Value sharply underperformed growth, and smaller-caps generally did worse than larger-caps. The best performing equity style was large growth (the iShares Russell 1000 Growth Index), which lost “only” 4.2% for the quarter. At the other extreme was small value (the iShares Russell 2000 Value Index), was down just shy of 20%. REITs were beaten sharply lower as investors reacted negatively to deteriorating

March Benchmark Returns

	Mar	IQ	2009
Large-Cap Benchmarks			
Vanguard 500 Index	8.8%	-11.0%	-11.0%
Russell 1000 iShares	8.7%	-10.4%	-10.4%
Russell 1000 Growth iShares	8.9%	-4.2%	-4.2%
Russell 1000 Value iShares	8.5%	-16.7%	-16.7%
Mid-Cap Benchmarks			
Russell Midcap iShares	9.1%	-9.0%	-9.0%
Russell Midcap Growth iShares	9.5%	-3.4%	-3.4%
Russell Midcap Value iShares	8.7%	-14.6%	-14.6%
Small-Cap Benchmarks			
Russell 2000 iShares	8.9%	-14.9%	-14.9%
Russell 2000 Growth iShares	9.0%	-9.7%	-9.7%
Russell 2000 Value iShares	8.8%	-19.6%	-19.6%
Other Benchmarks			
Vanguard Total Int'l Stock Index	9.3%	-13.0%	-13.0%
Vanguard Emerging Mkt Stock Index	16.0%	0.1%	0.1%
Vanguard REIT Index	3.8%	-32.1%	-32.1%
Vanguard Total Bond Mkt Index	1.5%	0.3%	0.3%
Merrill Lynch High-Yield Bonds	3.4%	5.3%	5.3%
Citigroup World Govt. Bond Index	2.5%	-4.8%	-4.8%
JPMorgan ELMI +	3.8%	-3.9%	-3.9%
DJ-AIGCI(Commodity Futures)	3.6%	-6.3%	-6.3%

fundamentals and fears about debt rollovers, and after a weak rebound in March finished the quarter down 32.1%. High-yield bonds, on the other hand, had the best showing of any of the broad asset classes we track, with a gain of 5.3% for the opening quarter. Abroad, the results for developed market equities were similar to what we saw at home. Vanguard Total International Stock Index Fund gained over 9% in March, but their 13% loss for the

“Be courageous. I have seen many depressions in business. Always America has emerged from these stronger and more prosperous. Be brave as your fathers before you. Have faith! Go forward!”

~ Thomas A. Edison

MISSION STATEMENT

Waterford Advisors exists to provide comprehensive financial planning services. We will accomplish this mission with excellence in everything we do.

We will provide independent, objective, and unbiased financial planning advice. Our only allegiance will be to our clients. We will have an unyielding commitment to the achievement of our clients' financial goals and objectives. To that end, we are committed to continually improve our people, processes, services, and facilities.

We will never lose sight of the basic premise that an uncompromising commitment to service and above all unquestionable ethics is the only true path to success.

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SHOULDN'T WE DO SOMETHING?

We are hearing from our clients that with all the uncertainty surrounding the current economic environment, the volatility in the markets and with anxiety so high, doesn't it make sense to be doing something about it?

Amidst a painful experience, the desire to "do something about it" can be overwhelming. Feeling seemingly powerless to forces beyond your control can be frustrating and frankly, scary.

But one thing that will remain true in spite of the current uncertainty: making sound investment decisions requires a rational approach in which careful analysis and thorough research - not emotions - underlie sound decisions.

... making sound investment decisions requires a rational approach...

Remaining invested and remaining true to our investment philosophy may feel to some like we are not doing anything or not doing enough given the environment we're in. Nothing could be further from the truth. We want to be sure our clients understand what we are and what we are not doing in this environment and why.

What We Are Doing:

We've added downside protection to our portfolios without

sacrificing longer-term returns. We have taken a number of steps in our portfolios that we feel will be advantageous to our clients over the longer term. We have added a number of funds that have eclectic mandates that will allow the fund managers to seek returns outside of traditional equities. Such funds have the ability to build up cash, invest in fixed income, invest in currencies and precious metals, and hedge their portfolios against declines in the equity markets. We have also been underweighted to equities in favor of high-yield bonds. Our return expectations for high-yield bonds over the next 5 years is comparable to equities but with less risk and a narrower range of potential outcomes.

We continue to make decisions based on assessing risk and return over our longer-term investment time horizon. There is much economic uncertainty today; however, we can still assess potential returns after taking into account a very poor economic recovery that encompasses even the most negative scenarios. By doing this we can make decisions with confidence if we believe we can earn an acceptable longer-term return under even the most pessimistic scenarios.

We are taking nothing for granted. We remain willing to take on investment risk, since the investment opportunities being created allow us to be very selective in which risk to take. We work to identify only those investment opportunities that have a very high

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INVESTMENT PORTFOLIO DESIGN BASICS:

Investment success is not a result of catching a ride on a hot stock, nor is the achievement of one's financial goals contingent upon buying the right mutual fund before it rises to the top of one of the many ranking services. Certainly, investors would rather hire good managers than poor ones, but investors' ultimate ability to achieve their financial goals is much less dependent upon these factors than many would believe.

While the specific investments comprising a portfolio are an important element, their significance should not be overstated. The starting point for developing appropriate portfolios is the analysis of one's personal financial goals and objectives. Consideration of the individual's capacity for future savings, current and expected future income, tax circumstances, risk tolerance, and timing of required cash-flows are all critical matters to be contemplated at the beginning of the portfolio construction process. Please note the absence of age as

Portfolios have two distinctive phases; the Accumulation Phase and the Distribution Phase.

a determining factor. The effect of each of these variables should be incorporated into the portfolio's design in order to have a high probability of achieving the goals that the portfolio is put in place to achieve. Only after evaluating all these factors should steps be taken to design the optimal portfolio. Note that the portfolio serves the financial plan; the portfolio is NOT in and of itself a financial plan.

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SHOULDN'T WE DO SOMETHING?

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We are not going to try to time the bottom of the market: No one knows where the bottom is. Let me repeat this: **NO ONE KNOWS WHERE THE BOTTOM IS.** Since a rebound can be sharp and unexpected, taking advantage of a deeply undervalued investment requires the willingness to accept some downside risk in the short term in order to take part in the eventual rebound. Market timing is a fool's errand and can have a significant detrimental impact on the long-term returns you ultimately realize.

We are not going to allow ourselves to be anchored to a prior way of thinking: Intellectual honesty requires a willingness to consider new ideas and new ways of thinking, and we will continue to challenge every assumption and remain open to new information should it deserve to influence our analysis and decisions.

We are not going to abandon our core investment philosophy: Our core investment philosophy has not changed. We still believe in:

Core Principles:
Asset allocation
Broad Diversification
Re-balancing

Core Practices:
Patience
Discipline
Faith in the Future

Following these Core Principles and Practices has always been and will always be the keys to investment success.

Trying to Predict the Market? STAY IN THE MARKET – DON'T MISS YOUR WINDOW OF OPPORTUNITY

Hypothetical \$1,000 investment over 20-year period (9/30/88 – 9/30/08)*



*Source of chart data: Ned Davis Research 9/30/08
Past performance does not guarantee future results.

"How many times does the end of the world as we know it need to arrive before we realize that it's not the end of the world as we know it?"

~ Michael Lewis
Editor of the book of essays
Panic: The Story of Modern Financial Insanity

INVESTMENT PORTFOLIO DESIGN BASICS:

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One of the most important but misunderstood decisions we make when recommending a portfolio's construction/design is the time horizon of the investment strategy. The time horizon of the investment strategy is defined as the anticipated point in time when cash will begin flowing out of the portfolio. Based on the portfolio's timing of cash-flow requirements, the following decisions can be made:

- *Determine which asset classes* (i.e. cash, bonds, equities) to consider in the portfolio's design.
- *Determine the mix* (% in cash, % in bonds, and % in equities) among those asset classes that will make up the portfolio.
- *Determine the sub-asset classes to be considered.* (i.e. domestic vs. international bond and stocks)
- *Select the money managers or mutual funds to be utilized.*

It is important to note that portfolios have two distinctive phases: the Accumulation Phase and the Distribution Phase.

ACCUMULATION PHASE

In the Accumulation Phase, cash-flow requirements may not take

place for many years. In such cases, portfolios are designed primarily based on the rate of return needed to achieve the desired financial goals with risk tolerance being a secondary consideration.

DISTRIBUTION PHASE

In the Distribution Phase, cash-flow requirements are either currently taking place or will be taking place in the near future (1 – 5 years). The distribution phase represents an entirely different experience for individuals. They are no longer investing money, but are now withdrawing money from their portfolio. As a result, the portfolio needs to be designed with the following characteristics:

One of the most important but misunderstood decisions we make when recommending a portfolio's construction/design is the time horizon of the investment strategy.

Cash-flow requirements for the first 1 - 3 years are being satisfied by cash on hand and the portfolio's current annual yield (i.e. annual interest and dividends produced by the portfolio). This is done to ensure that immediate cash-flow needs will be satisfied without

ever having to sell an investment prematurely. With the typical Bear Market lasting 14 – 16 months, we never want to be in a position where we would be required to sell an investment to meet a cash-flow requirement when the market is down.

The future cash flow requirements of the distribution phase (typically years 7 - 9) are generally invested in fixed income funds (i.e. bond mutual funds). These investments typically have yields that are higher than cash & cash equivalent investments, but are not subject to the higher levels of volatility that equity investments incur.

The balance of the portfolio is invested in equity mutual funds to provide for the growth needed to sustain the portfolio over longer periods of time. Even with mild inflation of 3%, cash-flows will need to double over a 20-year period just to maintain the same purchasing power. It is noteworthy that the percentage of rolling periods with positive returns for the S&P 500 (a proxy for the equity market) over all periods from 1926 through 2008 is 96.5% over all 10-year periods, and 99.7% over all 15-year periods.*

Designing the Distribution Phase of a portfolio in this manner greatly reduces the risk of being forced to sell, and gives us the opportunity to decide when to sell investments to meet cash flow requirements.

* Past performance does not guarantee future results.

SHOULDN'T WE DO SOMETHING?

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likelihood of rewarding us over the long-term investment time frame.

What We Are Not Doing:

We are not going to eliminate equity exposure and wait on the sidelines until 'things' improve:

Our investment approach is based on long-term (five years and beyond) return expectations. So while we are confident that from current levels stocks offer good long-term return potential, we don't know (nor does anyone else) what might happen in the short term. Equities could drop further, or they could rebound sharply. If we foolishly try to predict either of these outcomes and invest accordingly, we would have to consider the consequences of being wrong. If we went to cash, the market could rebound sharply before we can get back in. We could see a material portion of a good multi-year return potential realized while we were sitting on the sidelines waiting for 'things' to improve. On the other hand, if we remain invested, our analysis (and history) gives us confidence that we will earn a positive return over our long-term investment time horizon, independent of what the short-term brings. Longer-time horizons have the highest value when short-term fear is the greatest because that is when the best investment opportunities are created. Unfortunately, those are also the times when a long-term horizon is the most difficult to sustain.

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Investment Commentary

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quarter was a bit worse than that of domestic equities. In contrast, emerging markets equities had a great March and finished the first quarter slightly in the black, based on Vanguard Emerging Markets Stock Index Fund. Turning to bonds, Vanguard Total Bond Market Index Fund was up 1.5% for the month, bringing their year-to-date results slightly into the black.

Although we are obviously not happy to see another down quarter for our model portfolios, we are encouraged that relative performance has been strong versus our benchmarks so far in 2009. This reflects value added in aggregate from our tactical asset allocation positions as well as improvement in the performance of our active managers.

We Are Taking Nothing for Granted

We have talked about the risks and uncertainty in the economy and the financial markets for some time now. At the same time, we want to emphasize that we are resolutely focused on meeting these challenges with process and discipline. In addition to faith in the future, discipline and patience, we think our ability to navigate this environment and make effective long-term decisions requires that we think creatively, expand

our knowledge base, continually challenge our analysis and assumptions, seek new data, and discuss our views with experts in the field, in particular those whose analysis or opinion may differ from ours. We want to think carefully about how we could be wrong, particularly in terms of assessing the downside risk. We also need to have the intellectual honesty and humility to change our view or admit a mistake if we find that the original reasons for our investment thesis no longer hold true as a result of new developments.

Although we think a tough road is likely in the months ahead, both for the real economy and for the financial markets, ultimately we are confident that the economy will emerge from this deep and painful period, albeit on a more subdued growth path than in past recoveries. We hope we are positively surprised and that a sustainable recovery takes hold more quickly than we expect and that our optimistic scenario plays out. But we are not managing our portfolios based on that hope. Instead, as always, we strive to analyze the situation rationally and in depth, weighing the potential risks, rewards, and outcomes in order to make the best investment decisions we can on our clients' behalf.

"If I'd just listened to CNBC I'd have a million dollars today, provided I started with a hundred million dollars."

~ Jon Stewart
on The Daily Show with Jon Stewart

Tax Corner

Traditional IRA Deductibility Schedule

Modified Adjusted Gross Income (MAGI)¹

Fully deductible up to lowest amount in income range and phased out within the range

FOR INDIVIDUALS COVERED BY AN EMPLOYER-SPONSORED PLAN			
YEAR	SINGLE	MARRIED, FILING JOINTLY	
2008	\$53,000-\$63,000	\$85,000-\$105,000	
2009	\$55,000-\$65,000	\$89,000-\$109,000	
FOR INDIVIDUALS NOT COVERED BY AN EMPLOYER-SPONSORED PLAN			
YEAR	SINGLE	MARRIED, FILING JOINTLY	SPOUSE IS COVERED
2008	UNLIMITED	UNLIMITED	\$159,000-\$169,000
2009	UNLIMITED	UNLIMITED	\$166,000-\$176,000

IRA Contribution Limits

Total Contributions to all Traditional and Roth IRA Accounts

AGE	2008-2009
UNDER 50	\$5,000
50 AND OVER	\$6,000

Roth IRA Eligibility for 2008-2009

IF YOUR FILING STATUS IS:	AND YOUR 2008 MAGI ¹ IS:	THEN YOUR 2008 ALLOWABLE ROTH IRA CONTRIBUTION IS:	AND YOUR 2009 MAGI ¹ IS:	THEN YOUR 2009 ALLOWABLE ROTH IRA CONTRIBUTION IS:
SINGLE AND UNDER 50	UP TO \$100,999	FULL \$5,000	UP TO \$104,999	FULL \$5,000
	\$101,000-\$115,999	PARTIAL: [(116,000-MAGI)/\$15,000]x\$5,000	\$105,000-\$119,999	PARTIAL: [(120,000-MAGI)/\$15,000]x\$5,000
	\$116,000 AND ABOVE	NO DEDUCTION	\$120,000 AND ABOVE	NO DEDUCTION
SINGLE AND OVER 50	UP TO \$100,999	FULL \$6,000	UP TO \$104,999	FULL \$6,000
	\$101,000-\$115,999	PARTIAL: [(116,000-MAGI)/\$15,000]x\$6,000	\$105,000-\$119,999	PARTIAL: [(120,000-MAGI)/\$15,000]x\$6,000
	\$116,000 AND ABOVE	NO DEDUCTION	\$120,000 AND ABOVE	NO DEDUCTION
MARRIED, FILING JOINTLY AND UNDER 50	UP TO \$158,999	FULL \$5,000	UP TO \$165,999	FULL \$5,000
	\$159,000-\$168,999	PARTIAL: [(169,000-MAGI)/\$10,000]x\$5,000	\$166,000-\$175,999	PARTIAL: [(176,000-MAGI)/\$10,000]x\$5,000
	\$169,000 AND ABOVE	NO DEDUCTION	\$176,000 AND ABOVE	NO DEDUCTION
MARRIED, FILING JOINTLY AND OVER 50	UP TO \$158,999	FULL \$6,000	UP TO \$165,999	FULL \$6,000
	\$159,000-\$168,999	PARTIAL: [(169,000-MAGI)/\$10,000]x\$6,000	\$166,000-\$175,999	PARTIAL: [(176,000-MAGI)/\$10,000]x\$6,000
	\$169,000 AND ABOVE	NO DEDUCTION	\$176,000 AND ABOVE	NO DEDUCTION

“Despair is inappropriate for a culture as buoyant as our own”

~William F. Buckley, Jr.
1925-2008

2009 Retirement Plan Limits

Retirement Plan Annual Limits

	2008	2009
MAXIMUM SALARY DEFERRAL TO 401(K), 403(B) AND 457 PLANS	\$15,500	\$16,500
MAXIMUM SALARY DEFERRAL TO SIMPLE IRAs	\$10,500	\$11,500
MAXIMUM ANNUAL COMPENSATION TAKEN INTO ACCOUNT FOR CONTRIBUTIONS OR BENEFITS	\$230,000	\$245,000
LIMIT ON ANNUAL ADDITIONS TO DEFINED CONTRIBUTION PLANS	\$46,000	\$49,000
LIMIT ON ANNUAL ADDITIONS TO SEPs	\$46,000	\$49,000
ANNUAL COMPENSATION THRESHOLD REQUIRING SEP CONTRIBUTION	\$500	\$550
ANNUAL BENEFIT LIMIT UNDER DEFINED BENEFIT PLANS	\$185,000	\$195,000
THRESHOLD AMOUNT FOR DEFINITION OF HIGHLY COMPENSATED EMPLOYEES	\$105,000	\$110,000
THRESHOLD AMOUNT FOR DEFINITION OF KEY EMPLOYEE IN TOP-HEAVY PLANS	\$150,000	\$160,000
CATCH-UP CONTRIBUTION LIMIT FOR 401(K), 403(B), SARSEP AND 457 PLANS	\$5,000	\$5,500
CATCH-UP CONTRIBUTION LIMIT FOR SIMPLEs	\$2,500	\$2,500

Recent New York State Changes:

The Enacted Budget includes taxes and fee actions that will produce \$5.3 billion in revenues in 2009-10. The largest increase is a temporary Personal Income Tax Surcharge for higher-income taxpayers. This will temporarily increase the marginal State personal income tax rate for higher income filers for a three-year period from tax year 2009 to tax year 2011. For married couples filing jointly, the marginal rate will increase from 6.85 percent to 7.85 percent for filers with incomes above \$300,000 and 8.97 percent for filers with incomes above \$500,000. This surcharge is expected to produce \$4.0 billion in revenue in the 2009-2010 fiscal year, which is an amount that is approximately equivalent to the \$4.7 billion increase in the deficit that has occurred since the passage of the 2008-09 Deficit Reduction Plan on February 3rd.

1. Modified Adjusted Gross Income (MAGI) is determined before any IRA deductions.