



SPINNAKER

SPINNAKER TRUST QUARTERLY NEWSLETTER

JULY, 2010

Strong Headwinds Around the Globe

Last quarter we titled our newsletter, Major Issues, Mild Markets. Well, as we thought might happen, the market caught up with the issues as the mood of investors shifted.

Led by bad news in Europe, a potential slow down in China and a disaster in the Gulf, markets around the world declined while volatility roared back. The second quarter of 2010 is the first negative quarter since the first quarter of 2009 and has turned the first half of the year to negative territory.

The S&P 500 declined -11.4% for the quarter and is now -6.7% year-to-date. All sectors of the economy were down with

energy stocks leading the way at -13.2% for the year. The spill (tragedy) in the Gulf is weighing heavily on that sector. Technology, basic materials and telecomm also have fallen double digits for the year. Small and mid-cap stocks ended June down about 2% for the year.

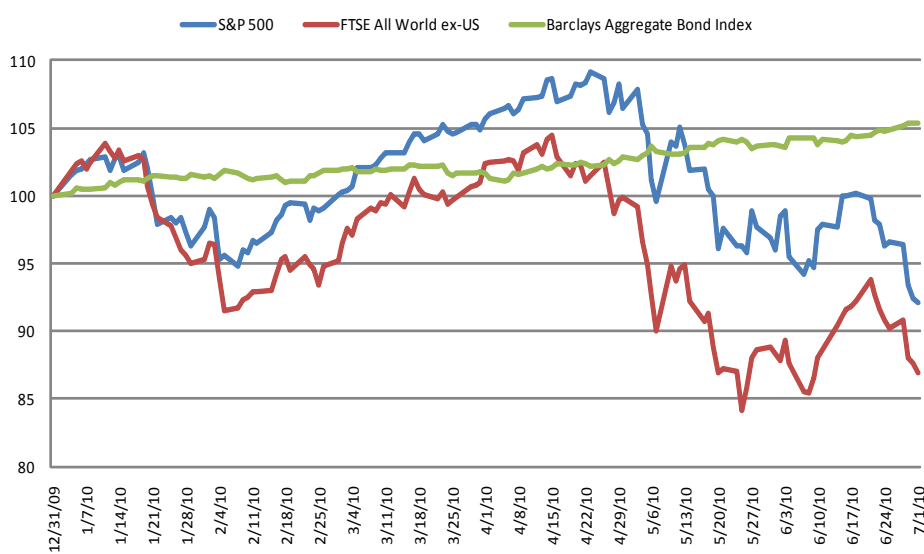
International equities, both developed countries and emerging, are solidly in negative territory for 2010 with developed countries taking the brunt of the fall. For the first half of the year, the EAFE index (Europe, Australia and the Far East) is down 16% while emerging markets in general are down about 12%.

While we don't know how long and deep the correction in equity markets will be, remember that between the lows in March of 2009 and the highs in April of 2010 both the S&P 500 and EAFE were up almost 80% and emerging markets over 115%. A correction was inevitable. The bigger question is, what does the second quarter decline portend for the balance of 2010.

Stimulus and Austerity: Can they live together?

Should developed countries continue to stimulate their economies to grow their way out of their problems (as the United States has been trying to do) or get their financial houses in order by reducing budget deficits (as most prominently espoused by Germany)? The G-20 meeting in late June seems to be looking for a little of both – committing to reduce budget deficits by one-half by 2013 but also agreeing that economic growth is the primary goal. If countries can accomplish this, over time, it should lead to a more stable global economy that should be less prone to imbalances. However, the

2010 YTD Stock and Bond Markets



transition will be neither quick nor simple.

Employment, or more specifically unemployment, is the major domestic issue that will not go away quickly in the U.S. At Spinnaker Trust we have been concerned about this for some time, and there is nothing happening in the economy that suggests unemployment will improve soon. Corporate America has moved on without re-hiring the majority of laid-off employees. Small businesses will have to pick up the slack and, although it is possible, it will take time and could be a drag on the U.S. economy for many more months.

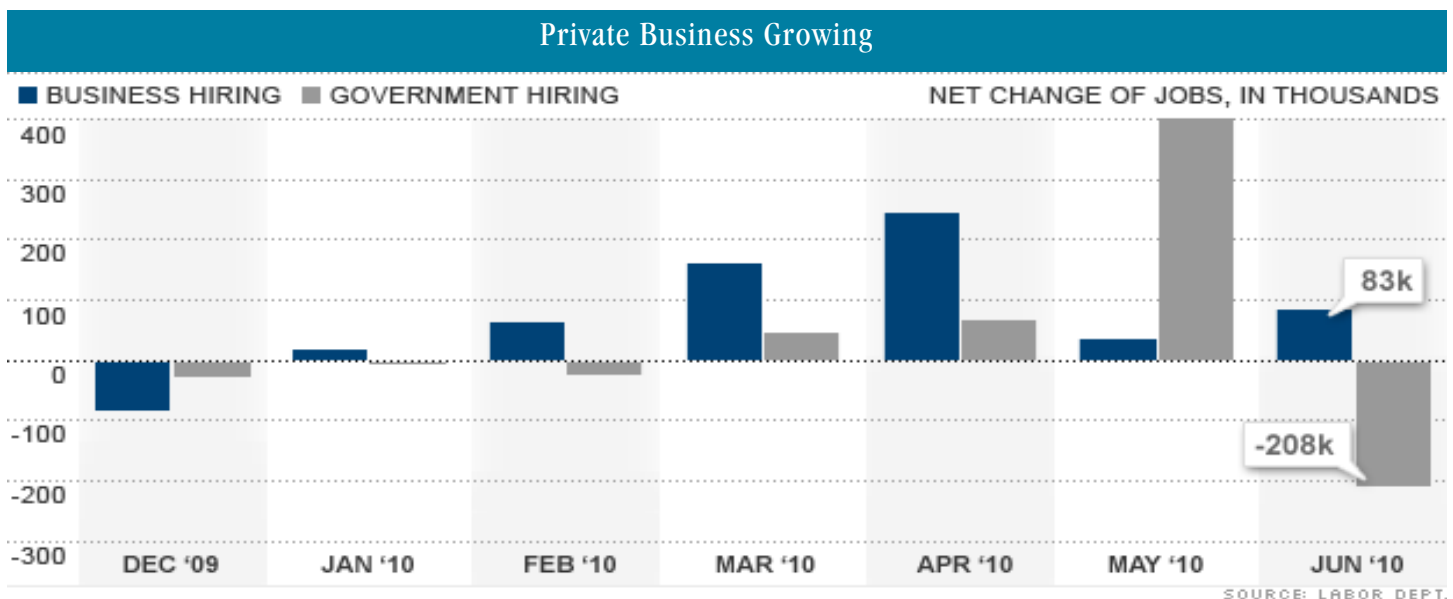
While June payroll numbers were disappointing, June marks the sixth consecutive private monthly job gain, and seven of the last eight months have seen positive growth. It's consistent with the kind of sub-par recovery that has been our expectation and, give or take a percentage point, the consensus of professional forecasters. Slow growth may not be satisfying, but it is not a new recession.

Almonds, Lobsters and Blueberries

Speaking of small businesses, a major component of the global transformation that is taking place will be the ability of emerging markets to transform their economies from reliance on exports to boosting personal income and consumption and, in fact, importing some items. China will be the poster child for this process. Articles in local and national papers provide anecdotal evidence that this process is beginning. We have seen several stories in the past few weeks about small business groups going directly to China to find markets. According to the California Almond Board, this year China will emerge as the top buyer of American almonds. Pecan and walnut growers are also successfully tapping the Chinese market. The New York Times reports that "China bought \$737 million in tree nuts from the United States last year, up from \$89 million just five years ago." Locally, MaineBiz reports that Maine's largest blueberry grower, Wyman & Son, visited China and hopes to

export blueberries in the next few years. And we have recently seen photos of Chinese food importers on Maine lobster boats on the cover of the Maine Sunday Telegram. These efforts are under Wall Street's radar, but point to a long-term adaptability and a willingness to change in small companies.

Are we pinning too much hope on the Chinese market or are U.S. businessmen and women finding ways to make inroads regardless of economic headlines? People have been talking about opening up the Chinese markets for 200 years, and the potential market is huge. Only recently has it really been possible. Travel is easier. Communication is easier. Chinese society is starting to open up. Even if only about 5% of the Chinese population is middle class and can buy almonds, lobster and blueberries, that is a huge number of people.



For Now

As we said, we do not know how long or deep this correction will be, but we do not feel we will double dip into another recession. Spinnaker Trust equity portfolios are broadly diversified among 10 economic sectors, all market capitalizations and include investments around the globe. Our portfolios own over 3,500 stocks through ETF's, virtually eliminating single stock risk. All of our portfolios also have at least some bond holdings to help dampen volatility, and many have 30% - 40% fixed income. This asset allocation is based on each portfolio's needs and each client's risk tolerance.

The Family Savings and Loan

We have written before in this column about the estate and gift planning opportunities available in this difficult economic environment. In a prior newsletter, for example, we explored the use of Grantor Retained Annuity Trusts and Charitable Lead Trusts. Both of these techniques are particularly effective when interest rates are low. This quarter, we will focus on an even easier way to take advantage of these low interest rates, namely, by making loans to family members.

It is sometimes forgotten that gifts to family members (or anyone for that matter) include not just transfers of cash or property for no consideration, but also transfers of property for less than fair market value. If you take an extreme example, this becomes obvious. One cannot get around the gift tax

rules by "selling" real estate to someone for \$1, for example. Also included in the definition of gifts are below-market interest rate loans. If an individual makes a below-market interest rate loan, the lender must treat the foregone interest on the loan as a gift. The IRS punishes this arrangement even more by demanding that the person making the loan include the foregone interest in his or her taxable income for the year, thereby being taxed on the imputed income.

With these adverse gift and income tax consequences, most experts do not recommend the use of interest-free loans to their clients. If a client makes a loan to a family member, there is a safe harbor interest rate that may be used to insure that the loan will not be treated as a gift. These "applicable federal rates" are published monthly. The July rates stated below are historically low.

Short Term (term of 3 years or less)	0.61%
Mid Term (term of 3 to 9 years)	2.35%
Long Term (term exceeding 9 years)	3.94%

Families can use these rates to their advantage in a couple of ways. The most obvious use of the family loan is as a substitute for a more traditional mortgage or other loan that the family member would obtain from a bank. For example, mom and dad could loan a child the money to buy a house with a 30 year fixed rate loan at 4%. While the market mortgage rates are very low right now, they are not that low, nor are they is-

sued without tremendous investigation into the borrower's circumstances, underwriting, appraisals and fees.

Alternatively, a family could use these interest rates to loan cash or securities as a way for children to make investments. Whether the children use the loan to invest in their own business or some other passive investment vehicle, including traditional securities, if their return on the investment exceeds the interest rates above, it is a win for the family. Using this type of safe harbor loan may also provide the benefit of having investment income taxed at a lower rate if the children are in a lower income tax bracket. As always, we would be happy to discuss the possible advantages of an intra family loan with our clients and their tax advisors and help determine whether such an arrangement would be beneficial for everyone involved.

MARKET DATA: 2010, 2009, 2008

<i>Index</i>		<i>6/30/10</i>	<i>2009</i>	<i>2008</i>
S&P 500	<i>U.S. Large-Capitalization Stocks</i>	-6.7%	26.5%	-37.0%
S&P 400	<i>U.S. Mid-Cap Stocks</i>	-1.4%	37.4%	-36.2%
S&P 600	<i>U.S. Small-Cap Stocks</i>	-0.9%	25.6%	-31.1%
Russell 1000	<i>U.S. Large- and Mid-Cap</i>	-6.4%	28.5%	-37.6%
Russell 1000 Growth	<i>Growth Stocks broken out</i>	-7.6%	37.2%	-38.4%
Russell 1000 Value	<i>Value Stocks broken out</i>	-5.1%	19.7%	-36.8%
MSCI EAFE Index	<i>Established International Markets</i>	-12.8%	32.2%	-45.1%
MSCI Emerging Markets	<i>Developing International Markets</i>	-6.2%	78.5%	-54.4%
		<i>6/30/10</i>	<i>12/31/09</i>	<i>12/31/08</i>
90 day T-Bill	<i>Short-Term Interest Rate</i>	0.16%	0.08%	0.08%
10 Year US Treasury Rate	<i>Longer-Term Interest Rate</i>	2.93%	3.82%	2.21%
VIX Index	<i>Risk Measurement</i>	35	22	40
Corporate Bond Spread	<i>Risk Measurement</i>	158 bps	122 bps	570 bps
TIPS Spread	<i>Inflation expectations</i>	185 bps	241 bps	17 bps

