

2010 Second Quarter Review

The markets have definitely been testing our risk tolerances as investors this quarter. Since April 1st, the markets have brought us another correction based on fears of collapse in the Euro Zone that we just can't seem to snap out of as of this writing. To our surprise, the European leaders seem to be taking the stance of austerity as opposed to bailout via more debt. That is good news for Europe in the long run, but will continue to cause volatility in the markets until European leaders reach a consensus on how austerity is to be implemented.

Nothing much has changed on the interest rate and inflation fronts, with both remaining low to nil. The Fed will most likely keep rates at 0% for all of 2010 – bad news for savers and persons living on their income, potential good news for investors in stocks. The U.S. recovery is slowing, but not faltering, which is normal after the early stages of recovery. Depending on how much the Euro Zone problems affect our country, the White House may recommend another round of stimulus, despite our growing debt. The dollar continued its rally as panicked investors bought U.S. Treasuries in a flight to safety, ignoring our looming debt problem. In other words, the U.S. was perceived as the least rotten apple of the bunch.

At times markets will act irrationally, especially in times of extreme exuberance and fear. Despite fundamentals being fair for a recovery, what started as what we felt to be another routine correction in a cyclical bull market, has now morphed into a correction which is being driven by fear and is gaining momentum.

Prior to this correction, we had a nice run in the markets. These recent events, reminded me of this adaptation from Nassim Nicholas Taleb's best-selling book, *The Black Swan*, in which he tells the short story of a turkey who is fed by the farmer every morning for 1,000 days. "Eventually the turkey comes to expect that every visit from the farmer means more good food. After all, that's all that has ever happened so the turkey figures that's all that can and will ever happen. But then Day 1,001 arrives. It's two days before Thanksgiving and when the farmer shows up, he is not bearing food, but an ax. The turkey learns very quickly that its expectations were catastrophically off the mark. And now Mr. Turkey is dinner." Mr. Taleb's advice? Let's not be Turkeys.

I thought this was a very clever analogy describing how investors seem to extrapolate past events into the future which forms expectation. During time periods of rising markets, investors seem to redefine risk from the possibility of loss, to the possibility of being left behind. Succumbing to these emotions, investors want to increase their equity exposure, just as the markets get more and more expensive setting the stage for a costly lapse in judgment. You must be disciplined and follow your allocation of stocks and bonds discussed with your advisor for the long term, no matter how high markets go, because they go down, too. Risk tolerances do not rise with markets.

The converse of this can be applied as well. In times of fear and panic, when things are cheapest and risk is low, investors perceive risk to be at its highest and miss great opportunity. Instead of reinvesting in stocks, they want out all together. Let's try to prevent these phenomenons from happening by working together.

- Chris Ginder, Vice President/Portfolio Manager

Email Connection!

With the world moving faster and faster all the time, KLC is attempting to keep you apprised of our thoughts of current events, what has happened in the market, etc. After the May 6th thousand point drop, we sent out an email blast, of which only about 25% of the emails were read. We don't know why that happened, but conjecture is that many of your email addresses have changed over the time you have been with KLC.

Although not everyone is interested in email, many of you are. It's important to update our records with an accurate email address, so we are asking if you would email our office at csfairbairn@klcinvest.com, so Corinne will be able to update our files with your latest email addresses. Usually, we obtain an email address from you when you open an account, but addresses change all the time.

Distributions

One of the awesome parts of working with Schwab Institutional is the ability to use their MoneyLink system. MoneyLink enables KLC to deposit funds directly and usually expeditiously into your checking account, and also to make withdrawals from your checking account for deposit directly into your investment account(s) at Schwab. As an example, I ask Linda Weber (KLC Operations Manager) to pull \$5,000 from my checking account and she makes the withdrawal, depositing the funds into my Schwab account. I need \$5,000 in my checking account, give her the verbal authorization, and she does the reverse. It's efficient, easy and quick.

Of course, we don't want MoneyLink to be used as a weekly transaction; however, transfers need to be made. Many KLC clients are receiving monthly distributions from their accounts. Required Minimum Distributions (RMDs), etc. can all be "directly deposited" into one's bank accounts. It's fabulous; no more checks being mailed to the address of record, no more waiting for 5 business days for a distribution.

However, these expeditious distributions can only be made if the money is sitting in money market funds (cash) within your account. We have had clients call and need money for a new car, a large medical bill, vacation, building a house, etc. and they call needing the money that day. This is not possible. Next day is possible, but only if the funds are in cash within your account and if MoneyLink is set up to the current bank account.

If funds are not available, we need to free up cash by placing a trade. This means the funds may be available within a day, but for stocks and bonds, it's a three day transaction. Holidays affect the timeliness of distributions, if it's before or after 4 pm, if there is money in the account... There are many reasons we cannot make an immediate distribution. Plus, if a trade needs to be made, often what is quickest to sell may not be what is best to sell.

There are two ways to assure that funds are always available to you when you need them. The first is to always have a cash buffer in your account. We have clients who always want \$5,000 in "cash" (money market) so they can call for funds to use immediately. Easily accomplished!

The second alternative is to call when you are looking for a car, or charged a larger than usual bill on your credit card or are building a home, and we'll prepare for the distribution when the funds are needed. As with so much else in life, planning is better than being frustrated when the funds aren't available immediately. It is your money and we want you to be prepared when you need your funds.

- Sarah Young Fisher, President