

2011 Second Quarter Review

Economic Overview: Summer Malaise

After an impressive rally from the late fall of 2010 and into early 2011, we are seeing some consolidation as we head into summer. The debt ceiling vote looms August 2nd. We expect Congress to approve at the last minute, as usual. We are still positive on the markets with current inflation, interest rates, and expected GDP supportive of current valuations. Equities tend to like the combination of price stability, low interest rates, and GDP growth at least above 2%. However, if any one of those factors starts to diverge, our uptrend may be in danger. With the anemic growth in the M2 velocity measure of the money supply, low inflation and low interest rates seem likely.

The big question mark then will be how economic growth fares over the 2nd half of the year. More stimulus may be needed to maintain the recovery, since policy and regulations are posing more headwinds than tailwinds for growing organically. Unemployment is still unacceptably high and probably will be for some time. There seems to be a mismatch between workers' skills and employers' needs. We really need to see some leadership from Capitol Hill to address this area, but with polarization in D.C. at levels not seen since the Civil War era, this seems unlikely. Corporate America's balance sheets (what we invest in) are still in very good shape. Commodities have pulled back since our last writing, quieting the 'inflationistas' as of late. I expect as commodities rise again, they'll be back sounding the alarms - again. If you recall in our last writing, this is a very volatile part of inflation and one the Fed refers to as 'transitory'. In other words, they aren't going to be making policy decisions based on temporary fluctuations in commodity prices, however painful they may be for consumers in the short term.

We still expect the Fed to keep rates historically low for a longer time than most have thought. This is not good news for savers who are being forced to take risk to make some kind of return on their money. We can all thank the Fed for artificially keeping rates low, so that investors in U.S. Treasuries are now experiencing a negative real return on their money. In other words, the rate of inflation is higher than the return on the Treasury bond or bank CD. With rates near zero, it doesn't take much inflation to accomplish this. This tactic is referred to as "Financial Repression" and is the back door tactic being employed to pick the pocket of investors on the sly. It's a method used by the government to pay back less than what they owe by what's akin to stealing the difference between your return and inflation. This may sound confusing, so think of it this way: If your return after inflation is negative, it's positive to the person on the other side of the trade, since investing is a zero sum game. In this case, you the investor who invests in treasuries & bank CD's are the loser and the government is the winner. Since most voting citizens don't understand this phenomenon, it's politically pretty safe to do, as opposed to raising taxes and cutting popular social programs. Stay tuned for more of the same as the leadership in this country continues to come up short on any viable solutions for growth and debt reduction.

- Chris Ginder, Vice President/Portfolio Manager

Cash Is An Investment

Anyone who has been watching TV or reading the newspaper knows that the stock market has been interesting this year. The S&P was up almost 7% for the year through May, then dropped to being nearly flat, then again returned to up 7%. This volatility creates a challenging environment in which to invest, especially for new accounts or large inflows of cash. There is nothing worse than putting a large sum of money into the stock market only to see a 5% or 7% drop in market value within a week or so. So sometimes we wait. We may wait for the next round of earning reports or for a meeting of the Federal Reserve Board or for job reports or inflation numbers; the list goes on and on. So, while cash isn't earning any return at this time, it is not losing money. Please keep these thoughts in mind if you see a delay in investing cash in your accounts. This is an intentional investment decision on our part.

- Sarah Young Fisher, President

Donor Advised Funds

Opening an account at Schwab Charitable managed by KLC allows donors to potentially realize the greatest tax benefits of charitable giving while flexibly supporting their favorite charities over time. It is accessible to donors of all sizes and, unlike most planned giving alternatives, is simple, efficient, and low cost. It also enables donors to customize their experience and maintain their privacy, if desired. Please call Chris Ginder if you are interested in learning more.

Lesson from a Mortgage Nightmare

Recently, a client went to settlement for sale of her personal residence only to discover she couldn't settle. She almost lost her buyer due to an administrative nightmare. It seems that a lender had never satisfied a paid off line of credit on her home. The loan was paid in full in 2004 but the bank never satisfied the loan at the Court House. To be fair to the lender, especially with a line of credit, they don't always know if the loan is paid down to zero and remains open for future borrowing or if the line is actually being closed.

So, when you pay off a loan of any kind, please be sure to receive the formal paperwork back in a few weeks showing that the loan is paid in full. If the loan has been collateralized by your home, make certain the loan is satisfied at the Court House. You should receive a satisfaction piece in the mail. With the increase in bank mergers, it may be difficult in the future to secure the necessary documentation that the loan was paid in full, so get it now. Dealing with paperwork now should prevent a nightmare years later when you sell your home.

- Sarah Young Fisher, President

Housekeeping

We wanted to make you aware that if you currently receive paper trade confirmations in the mail, you can elect to consolidate these confirmations on a single report which is mailed quarterly. This report can be done for each account separately, or you can have all of your transactions separated by account number on the same quarterly form. For those of you who like to see the trades in the mail as they occur, this may not be for you, but for those of you who want to save a few trees and filing time, this may be right up your alley! Please call Dana Mealy if you are interested in this option.

Compound and Compare*

Approaching retirement with too little money is unfortunate. Furthermore, getting sucked into the daily hype that has people jumping in and out of the stock market can be disastrous. The market will inevitably go down once in a while, but history proves that despite this, the long term trend for the market is up. Taking that into account, the earlier an individual begins to invest, the better.

Data from the Bureau of Economic Analysis indicates that the U.S. overall savings rate has been drastically falling since the early 1980s, and only recently started to recover a little (since 2005). Even so, most people simply aren't saving enough for retirement, in an era when even more responsibility for retirement savings has been shifted from corporations to individuals.

This long-term lack of savings is partly a cultural phenomenon. Baby boomers have a stronger sense of optimism than the World War II generation, and have not placed the same priority on saving. Worse yet, they have relatively easy access to credit and a habit of spending beyond their means, regardless of how much money they make. This trend continued in subsequent generations. The problem is that nowadays people should be saving more, considering the declining availability in pensions provided by employers and the level of confidence in receiving Social Security benefits. The good news is that people have started to realize this recently.

By contributing early and often to an investment plan an investor's money compounds over time. Compounding, otherwise known as the ability of an asset to generate earnings from previous earnings, accelerates the growth of your assets over time. How does compounding work, exactly? Let's say you begin in year 1 by investing \$1,000. Year 1 proves to be a very good year for the market, and your investment returns 12%. You now have $\$1,000 + \$120 = \$1,120$. Year 2, however, is not so great, and your return for year 2 is now only 7%. The power of compounding is that you have now gained not 7% of your principal value (7% of \$1,000 = \$70), but 7% of your total investment value at the beginning of year 2: $7\% \text{ of } \$1,120 = \78.4 . Now imagine what continuous compounding over a longer period or time can do.

The growth of an account based on an investor's age and the amount contributed annually until age 65 is an example. The 30-year-old investor contributing \$8,000 per year will have nearly \$1.5 million at the age of 65. This is more than double the ending wealth value of an investor who saved the same amount per year but waited until age 40 to begin saving. It is quite clear that the earlier you start and the more you invest, the easier it is to achieve your retirement savings goal, thanks to the power of compounding investment returns.

But all is not lost for investors who do not start to aggressively save for retirement until they reach their 40s or 50s. The good news for these investors is that they still have enough time to change their savings behavior and achieve their goals, but they will need to act quickly and be extremely disciplined about their savings. Time waits for no one, so don't procrastinate-get started now.

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