

Planning & Investment News

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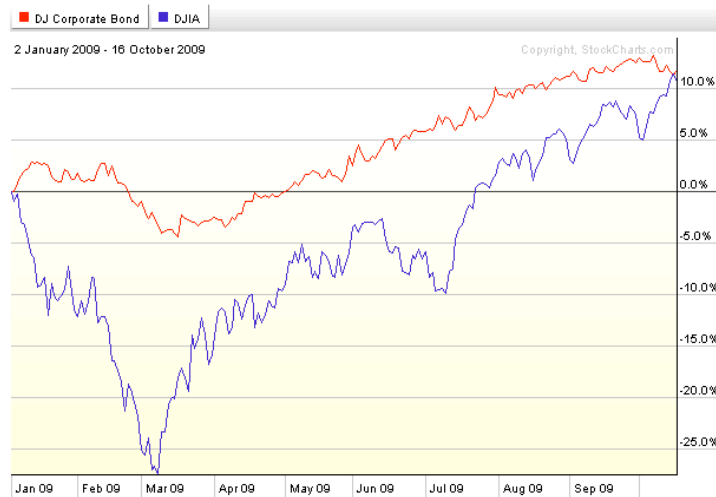
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DEBT AND THE ECONOMY

Since a low in March, the stock market has generated returns like few times in history. Admittedly, this performance caught us by surprise. After the meltdown in 2008, we repositioned most portfolios with a strong bond* component. This was done because a) we were nervous about the potential continued downside risk in the market and b) we thought the potential gains to be had in the bond market were especially attractive given the lower risk nature of bonds.

PerfChart: \$DJCBP,\$INDU



[http://stockcharts.com/charts/performance/perf.html?\\$DJCBP,\\$Indu](http://stockcharts.com/charts/performance/perf.html?$DJCBP,$Indu)

The above graph shows the return of the Dow Jones Industrial (blue line) and Corporate Bond (red line) Index*. The purpose of the chart is to attempt to show that bonds, as hoped, performed as well as stocks for the majority of 2009 with much less risk (note the drop in the Industrial Index in January and February). Since October, the stock market (as measured by the Industrial Index) has since outpaced the bond market for the year. We have been satisfied with the returns in the majority of our clients' portfolios this year.

*Bonds are in essence loans to corporations secured by their promise to pay and the assets of the company. As such, their value is based upon the perceived "credit-worthiness" of the company and the bond's interest rate. Equities, or stocks, represent an ownership interest in the company.

± An index is a portfolio of specific securities (common examples are the S&P, DJIA, NASDAQ) the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Indexes are unmanaged portfolios and investors cannot invest directly in an index. Past performance is not indicative of future results.

Even though stocks have recently outperformed bonds, we remain cautious and do not think the upside potential in the stock market warrants the potential downside risk. We are still positioning portfolios with the assumption that, at best, future stock market returns will be tepid.

The chart below is reflective of a large part of our reasoning of future mediocre returns. As shown, the level of debt in the U.S. has steadily increased since the 1970's. The increased debt fueled an increase in asset prices that appears to have at least partially burst with the mortgage crisis*. Like a frog in a boiling pot of water, we have become used to greater and greater levels of debt.



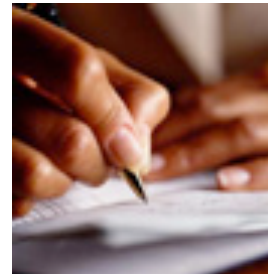
As the “shadow banking” system of mortgage derivatives imploded last year, the U.S. government has stepped in to fill the resulting hole. The federal government has made direct loans to companies such as AIG, General Motors, and the large banks. They have promoted an increase in personal borrowing primarily through low interest rates, but also with programs such as “cash for clunkers” and the first time homebuyers’ credit.

Thus the above chart, if brought forward to today, would show an even larger debt load. We do not know if the U.S. debt level is increasing too fast, but common sense would indicate that at some level the debt load will be unsustainable. Japan has a much higher debt load and, as would be expected, is in a much more precarious position. Both countries, among a whole host of others, will have to “pay the piper” at some point.

We wonder if the current administration’s actions are “just kicking the can down the road”. The underlying problem has not been addressed, just mollified. If you have ever had to pay down debt, you know there are few shortcuts. Debt reduction requires time and pain.

The U.S. consumer has fueled the global economy. If the U.S. consumer indeed has to cut back on spending in order to repair personal balance sheets, it is unclear who will step into the void to pick up the drop in global demand. And thus why we do not see how businesses, on the whole, are going to be overly profitable in the near term.

*As explanation of how the increased availability and use of credit increased asset prices, think about how much less your house would be worth if buyers were required to put down substantially more than the current customary 10% to 20%.



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Given the foregoing, we do not plan to change our over-all investment strategy in the near term. We will continue to investigate new investment vehicles we think suited for this particular market. And we will continue to watch for signs of inflation and attempt to position portfolios accordingly.

Please let us know if you would like to discuss how this economic outlook affects your personal financial situation. And, as our business depends on referrals, we would greatly appreciate the opportunity to work with your friends of similar values. Our commitment to you is to remain vigilant during these uncertain, though far from dull, times.

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