

Market Commentary: October 2011

Economic Armageddon predictions are flourishing. How can I scare thee? Let me count the ways: another U.S. recession, unemployment, home prices stagnant for another decade, U.S. dollar decline, threat of inflation, imminent Greece default, European Union collapse, Arab-Israeli conflict, terrorism. Then there are trivial issues like the newly appointed Congressional super committee charged with creating a plan by Thanksgiving that will cut \$1.2 trillion from the Federal budget and the recognition that we have entered a presidential election year! [I am sure that I have missed something in the above list that scares you. Feel free to add to the list.] Volatility or uncertainty is the word investors are using to describe the stock market. The correct word is fear.

When fear prevails, it is time to check our thinking. How often do you think about how you think? In the business of investing, one has to do this almost daily. It is the only way to ensure good decision making. One way I describe fear as it relates to our thinking is comparing it to darkness. If you are forced to walk into a dark unfamiliar room, despite being careful, you are likely to bump into the furniture and hurt yourself. If the room is only dimly lit, you may be able to make out images but the edges of furnishings will still be vague. The more light in the room, the more clearly the corners of the table become and the safer you are. The corners are still sharp, but now you can move about safely. Do you know the layout of your portfolio in the dark? Where are the sharp edges? Where are the safe assets in which you will move about when there is very little light? *Knowing this will help you make better decisions and reduce your fear; without it you will be in a dark room worrying about finding the next sharp corner the hard way.*

Speaking of corners, let's look at the chart below and the returns over the last quarter and year ending September 30, 2011. The strong positive 12 month equity returns we saw last quarter have been replaced by near zeros and a strong negative in the case of international stocks. As if told to fall in line behind stock, the fixed

	Benchmark Index	3 month return	12 month return
U.S. Stocks	S&P 500	-12.0%	2.0%
	Wilshire 5000	-13.0%	2.0%
	NASDAQ	-10.0%	5.0%
International Stocks	MSCI EAFE	-19.0%	-12.0%
Fixed Income	Short Term Bonds	0.5%	-0.5%
	TIPS (Treasury Inflation Protected Securities)	3.5%	5.0%
	Intermediate Term Bonds	4.0%	1.0%
	Aggregate Bond Market	3.0%	1.0%

income categories went mostly flat, with the exception of TIPS, for the year.

The late Louis Rukeyser, host of the long-running television show “Wall Street Week”, gave us a good description to understand the market. “Were it not for the market’s eventual awakenings to reality, investing would truly seem a hopeless gamble for the ordinary person. But the market’s short-term capriciousness can be a source of hypnotic fascination. For what the market truly represents is not a crystal ball or anything else of such mystic magnitude; it is an instant photograph of the ephemeral mood of a significant chunk of Americans.” Based on that description, the “weather” mood of investors in today’s picture is somewhere between stormy and foul.

Over the next year or more, with all the risks we read or hear about daily, we will very likely continue to find ourselves in a dimly-lit economic house. The run up to the presidential election alone is enough to ensure a certain level of fear. We cannot control that. *However, we can control how we think and move.* We can check our thinking to ensure that our investment decisions are not fear-driven. This alone will prevent mistakes. We will then move successfully through yet another recession using rational techniques to reallocate your portfolio based on objective factors, not the market, nor the desire for change’s sake. [My strong belief is that the wealth gap is going to grow, largely through more frequent recessions, and the success of future investments will depend on one's ability to rebalance in a disciplined way for years.] Investing intelligently does not require, nor benefit from, any emotion, but emotion always comes along for the ride. We need to ensure that it does not drive from the back seat.

As usual for this time of year, we will be working closely with you to shape the year-end tax picture. Our analysis will include appropriately harvesting gains and losses in the portfolio, Roth conversion opportunities, and extra IRA withdrawals to fully capture the lower tax brackets, as well as your gifting goals and more. Please ensure that we are aware of any special circumstances or desires you want us to consider.

Thank you for your trust. We look forward to our conversations and visits together. Oh, by the way, the trees are beautiful again. May you enjoy a wonderful autumn.

“Courage is the price that Life exacts for granting peace.” -Amelia Earhart

Carl Amos Johnson, MBA, CFP®, AIF®
October 1, 2011