

Private Wealth MANAGEMENT



Running Out of Gas...

While most Americans will be returning to the reality of the work week after the long Independence Day Weekend, investors will be returning to the reality of volatile financial markets and economic uncertainty on every corner. Since the financial crisis erupted in late 2008, our economy along with others around the world have been supported by massive government stimulus & bailouts, ultra-low interest rates (near zero), changes to accounting rules, and the largest expansion of money supply in history. In fact, although America turned 234 on her recent birthday, we (by “we” I mean the Federal Reserve) have somehow managed to double our money supply in just the last 4 years! That is not a typo...But now we seem to be “running on fumes” as the stimulus fades, bailouts vanish, and interest rates are about as low as they’ve ever been.

Normally, when ever there is a large increase in the money supply, inflation, in the form of rising prices, is on the horizon. But today’s environment is anything but normal. In fact, it is not inflation, but deflation which is the primary trend at the moment. This deflation, or trend in prices falling, is due to the enormous amount of slack built up in our economy. The most obvious places to see this slack is to look at the labor and housing markets.

We Need More Jobs!

Last week the headlines reported that the national unemployment rate dropped from 9.7% to 9.5%. That sounds like good news until you read the fine print. The rate dropped because over the last 60 days, nearly 1 million people have vanished from the payroll numbers. In other words, if you are unemployed, but have not looked for a job in the last 4 weeks, you are NOT counted as being unemployed—in fact, you are removed from the workforce—I couldn’t make this stuff up. So, if we added those people back, the unemployment rate would be closer to 9.9%¹.

First, let’s be clear about something—a growing economy produces more consumption. Growing consumption artificially (by temporary incentives) does NOT grow an economy—it disrupts and distorts it.

Our political leaders seem to be reasoning that because approximately 70% of our economy is based on consumption, more consumption is what we need to grow the economy. Hence the programs we’ve seen such as Cash-For-Clunkers, and the Home Buyer’s Tax Credit. In reality, all these programs do is bring forward future demand into the present. In other words, it borrows from tomorrow’s consumption. Demand for automobiles and homes, is still terrible even in the face of historically low interest rates (another artificial price disruption). In the remaining part of the year, I would not be surprised at another decline in home prices as the inventory or supply far exceeds any demand.

Risks & Rewards

¹ John Mauldin - *Thoughts from the Frontline Weekly Newsletter*

As we all know, investing is about balancing risks and rewards. Our approach, however, is to start by analyzing the risks first. In our experience, many investors make the mistake of looking first for rewards, and then trying to rationalize away any risks. This is not recommended.

Starting from a top-down view, the biggest risks include Europe's fiscal mess, a terrible labor market, a depressing housing market (even after 3 years), states and local governments going broke, and last but not least, ever growing uncertainty for businesses from new regulations, and legislation that is sure to be packed with unintended consequences.

And if that wasn't enough, most of us will be paying a lot more in taxes starting on January 1st.

As for global stock markets, both the fundamentals and technicals look dangerous at these levels, and we see more risk than reward at the moment. In addition, the leading economic indicators are signaling a global slowdown in trade and that would not bode well for risk assets.

Now for the good news...There still remain great opportunities for investors in other asset classes. As we mentioned earlier, deflation is still the primary trend and that should reward fixed income investors. Municipal bonds remain one of our favorite investments and may benefit from the upcoming increases in the income tax. Another area where there is still good yield and potential for long term gains is in the non-traded REIT (Real Estate Investment Trusts) space. Some of these funds are able to buy high quality income producing assets at below replacement cost. Moreover, although commodities (especially softs like Sugar, Corn, Soy, etc.) may continue to be volatile in the short term, patient investors could benefit substantially by the long term supply/demand imbalances around the world as we try to feed and fuel more than 6 billion people.

We take great pride and responsibility in managing our client's wealth and will continue to look for the best methods for protecting and conservatively growing portfolios.

We certainly look forward to reviewing with you either in person or via conference call so that we may catch up, exchange ideas, and agree on a strategy going forward.

As always, please feel free to send us your comments and/or questions.

Respectfully,

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Chief Investment Officer	Registered Principal

Disclosure: Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rate rise and are subject to availability and change in price.

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