

The Financial Navigator – October Newsletter

In this month's newsletter I wanted to review the 3rd Quarter and pass along some words of optimism from some of the more respected business leaders in the U.S.; Warren Buffet, Steve Ballmer of Microsoft, and Jeff Immelt of GE. I hope to provide some views on the economy to add some contrast to the pessimism permeating the media. Although the above executives' views may be motivated by business profits or encouraging their firms' stock price higher, I tend to find their views provide a better reflection of the true state of the economy, certainly better than politicians, and more often than not, than members of the 'dismal science', i.e. economist.

In addition, we provide some thoughts on predicting future interest rates and the accuracy of these predictions, which is a timely topic as the financial media jumps from worrying about inflation, and higher interest rates, to deflation and flat rates on a daily basis. Perhaps this is an exercise in futility as the data shows most predictions of future rates are abysmal when measured against the real results.

Sincerely,

Bill Simpson, CFP®, MBA
Azimuth Financial Planning, LLC
(603) 373-8793
bsimpson@azimuthplanning.com
www.azimuthplanning.com

The Third Quarter - Optimism In A Sea Of Pessimism

Let's begin with a short summary of stock market performance in 2010 to date. Markets in the last three months saw a continuation of the roller-coaster like turbulence of the past couple of years. After a strong first quarter and a big pullback in the second quarter, July saw a strong recovery in global markets.

This was followed by weak performance in August, and September (historically a troublesome month for markets) saw a big bounce back. The U.S. market experienced its best September since 1939. As a whole, global markets were up 9% for the third quarter and are up 2% in 2010 to date.

Here's how markets have performed in the last quarter and so far this year.

	U.S.	Europe	Emerging Markets	World Stock Market
July	+7.0%	+5.9%	+6.2%	+5.8%
Aug	(- 4.4%)	(-2.1%)	(-1.4%)	(-3.3%)
Sept	+ 9.1%	+5.3%	+7.7%	+7.0%
Q3	+11.5%	+9.1%	+12.9%	+9.4%
YTD	+4.0%	+2.3%	+8.2%	+2.0%

Source: MSCI index. All returns are in local currency

The importance of a balanced perspective

One of the keys to success for investors is maintaining emotional equilibrium – preventing the highs from being too high and the lows from being too low. Today, many Americans are pessimistic about the United States and global economies driven by daunting headlines heralding slow economic growth, depressed housing prices, high unemployment and deficit problems in the U.S. and Europe, not to mention political discord in Washington.

This pessimism is amplified by the media coverage given to voices of gloom such as noted economist Nouriel Roubini of NYU. Mr. Roubini has gained some notoriety by correctly calling the housing bubble in 2005...it should be noted he also called for a housing bubble in each of the previous five years. Is he a genius for making one correct call, or should he be considered a minor leaguer for batting 0.167 and demoted to the single-A team? Only in the world of economics, CNBC, and 24/7 financial news looking for the next star is he considered a financial messiah. Anyway, with this focus on the negative, it's easy to miss some of the good news beyond the headlines.

The Big Sky Conference: Looking past short-term issues

That's why a conference that took place in mid September is important, as it provided some offsetting perspective on the mid- and long-term positives for the United States and globally.

Speaking to 2,000 business and political leaders at "The Big Sky Conference" in Montana, here are comments from Warren Buffett, Steve Balmer - CEO of Microsoft and GE's CEO Jeff Immelt.

Warren Buffett:

"I'm a huge bull on this country ... we won't have a double dip recession. I see our businesses coming back almost across the board...it's night and day from a year ago."

"I've seen sentiment turn sour in the last three months or so, generally in the media. I don't see that in our businesses. I see we're employing more people than a month ago, two months ago."

"The things that worked for the country through a century of two world wars, a depression and more — all while increasing the standard of living — will work again."

Steve Ballmer, Microsoft:

"There soon will be more technological advancement and invention than there was during the Internet era and that will help drive business growth."

"We will see new technologies that move beyond the Internet to tie together computers, phones, televisions and data centers to create amazing new products. And the pace of innovation will increase as technology makes workers more productive."

Jeff Immelt, GE:

"Business at GE is improving. Signs across the world show growth improving as evidenced by a rise in GE's orders."

"GE is now finding it profitable to build manufacturing and service centers in the United States rather than overseas, because it is more competitive to do so."

The path ahead

These positive views are supported by recent research from McKinsey & Company, today's leading strategy consulting firm and the first place many Fortune 500 CEOs look for advice. McKinsey surveyed 2,000 executives around the world in early September.

- Almost 60% said their country's economy is in recovery.
- Most expect profits to rise from last year.
- And nearly 40% expect to hire employees by the end of 2010.

It's not realistic to suggest there won't be challenges ahead, both for global economies and for stock markets. And given the fragile market psychology, it's entirely possible that we'll see a market correction in the next 12 months. More sovereign debt issues similar to Greece and Ireland may arise along with other unpredictable economic developments; be prepared for a volatile ride as the world continues to work through the current credit-debt crisis.

At the same time, I believe it's important to pay attention to the encouraging perspectives from business leaders on the front lines and maintain a balanced perspective despite the market "noise".

Interest Rates are Headed Higher, Right?

With the economy slowly recovering last year from the worst recession in decades and the federal government seeking to tap the credit markets for over \$2 trillion to fund an ambitious spending program, both laymen and experts alike seemed to agree that interest rates had nowhere to go but up. The yield on the ten-year U.S. Treasury note as of June 30, 2009 was 3.52%, down from 5.25% in June 2007 but well above the 2.09% level registered amidst the depths of the credit crisis the previous December. With retail sales and housing activity showing signs of gradual improvement, the only question appeared to be how much higher interest rates would go.

Among fifty economic forecasters surveyed by the Wall Street Journal in June 2009, forty-three expected the ten-year U.S. Treasury note yield to move higher over the year ahead, with an average estimate of 4.13%. Seven expected a rate of 5.00% or higher while only two predicted rates to fall below 3.00%.

How accurate were these predictions? Well the ten-year Treasury yield slumped to 2.95% on June 30, 2010 and rates on 30-year mortgages fell to their lowest level since Fannie Mae began tracking them in 1971. How many of us would have expected this during a period when gold prices soared over 33% to a record high?

Some observers may be tempted to poke fun at these hapless "experts", questioning their competency and expertise. Perhaps this interpretation is flawed since it suggests that a better team of experts would achieve a more accurate result. A better explanation might be that even the most talented analysts are unlikely to make reliable predictions and the poor showing by this particular group is simply what we would expect to see, just as often as not, if markets are working freely and fairly. Today's bond prices already reflect expectations for tomorrow's business conditions and inflation and these expectations can change quickly in response to new information. However tempting it may be to believe that we can predict the future better than other market participants through careful study; the results of the Wall Street Journal survey as well as numerous other studies suggest this confidence is misplaced.

What is the take-away for investors? Simply, predicting interest rates and bond prices is no easier than predicting stock prices, and making decisions based on what appear to be certain outcomes at the time can often prove costly. Many investors reconfigured their portfolios in anticipation of higher interest rates and have penalized their results while they are waiting. Instead of seeking to predict the unpredictable,

investors are much more likely to enhance their results by focusing on the elements they can control – risk exposure, diversification and minimizing costs and taxes.

Yahoo! Finance www.yahoo.com accessed July 7, 2010. Wall Street Journal Forecasting Survey www.wsj.com accessed July 7, 2010. Prabha Natarajan and Matt Phillips. “Stocks Drop; So Do Mortgage Rates” Wall Street Journal, June 25, 2010.

Mark Gongloff. “Two Treasury Forecasts: a Grand Canyon-Sized Gap” Wall Street Journal, April 10, 2010.

Tom Petruno. “Gold Hits Record as Investors Seek Haven” Los Angeles Times, June 9, 2010.

If you have any questions on this topics, or need some help with other financial issues you are facing give me a call at (603) 373-8793.