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Mid-year is a good time to review our investment goals and share what we're focusing on, the assumptions we are using and what the current investment opportunities we see.

Our Investment Goals:

- Design, build and maintain *customized* investment portfolios to meet *your specific requirements.* (We offer you a free Financial Plan created by a CERTIFIED FINANCIAL PLANNER™ so that we all know what those requirements are.)
- Provide compounded investment returns over time, regardless of prevailing economic and market conditions, equal to X (where X is the *specific required return* indicated by your Financial Plan.)

Current Focus (of analysis):

Our intent in this letter is to address only those cyclical factors that are affecting asset prices now. Therefore the long-term, secular topics below will not be dealt with in detail or at all:

- First ever occurrence of a European double-dip recession.
- Expected reversion to the mean of corporate profits.
- Changing demographics and deleveraging of the developed world.
- Prospect of a permanent Chinese economic slowdown.
- Ramifications of Chinese financial sector reform.
- Contracting of government spending in developed countries.
- Supply windfall in natural gas supplies from shale.
- Increasing use of automation and robotics.

The best word to describe investor attitudes in recent weeks would be "panic." Worries of a looming global recession and Euro zone breakup sent investors piling into "safe haven" government bonds causing their valuations to skyrocket:

- U.S. 10-year Treasury bond yields fell to 1.47% causing the Corporate to Treasury bond ratio to reach spreads surpassed only by the 30's Great Depression and the 08' Lehman Bust.
- Swiss, German and Danish 2-year bonds had negative yields. Investors were paying these governments to take their money by agreeing to get back less than they loaned them!

Finding reasons to justify investor worries isn't difficult. One is the potential for disaster from Greece discarding the use of the Euro as its currency thereby causing a run on the banks and setting the stage for other countries like Spain, Italy and even France to abandon the Euro.

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Another concern is China's slowing growth and recent political turmoil. Officials there seem to have been caught flat-footed with the onset of slower global growth. Their Gross Domestic Product (GDP) growth has been cut in half in less than three years. Because consumer spending there is only 34% of GDP vs. 70% in the U.S. and per capita income is $5,400 vs. $48,400 here, China is largely dependent on exports to grow its economy but exports are slowing. The recent dramatic ouster and related scandal of Chongqing Communist Party boss Bo Xilai also weighed on investors.

In the U.S. fears that the Fed would end its "operation twist" were relieved when they continued the program which helps to keep interest rates low. Still, economic growth remained tepid May payroll count rising by only 69,000 workers - far below what is needed to reduce the 8.2% unemployment rate. The last three years have seen an unprecedented loss in state and local government employment of 662,000 or 17.6%. Lack of jobs has caused the number of 25-34 year olds living at home to jump from 10% to 14% and their homeownership rate to drop from 43% to 38%. And troubled homeowners aren't expected to pick up their spending as banks step-up foreclosure sales which on average depresses house prices by 19%. The average homeowner with a mortgage has only 17% equity so further house price declines would put many more homeowners under water.

The "Fiscal Cliff" also came into view with the threat of more political theatre and gamesmanship as the debt ceiling and Bush tax cuts expire on Dec. 31st. The Center for Responsible Budget estimates it would hit the economy by about $550 billion, reduce GDP by 2% and cause a U.S. recession. Meanwhile the U.S. growth was already slowing with 1st quarter growth revised down from 2.2% to 1.9% which was down from 3% in the 4th quarter of 2011.

Current Assumptions:

- The U.S. will have a mild recession and normal business cycle slowdown after 4.5 years of expansion. Exports to the European Union only account for 2% of US GDP.
- Large global banks will have credit ratings cut as new regulations are enacted curtailing proprietary trading and the global slowdown depresses lending. (As I write Moody's announced its downgrade of 15 global banks.)
- Much of the risk of a Euro breakdown is already priced into European stocks. Their relative prices are at the lowest level since the years prior to the fall of the Berlin Wall.
- China's reform policies will continue and the deal made to oust Bo Xilai will serve to unify leadership and help bring consensus. China has room to increase fiscal stimulus especially infrastructure spending and it will do so.
- Regardless of the election outcome they will kick the fiscal can down the road several months allowing the newly elected president and Congress time to implement their new mandate.
- House prices will continue to stabilize in a growing number of areas and reach wide-spread stability in 3-4 years. It will be 8-10 years before starter-homes see solid price increases from echo boomers (born in the late 70's to late 90's). Trade-up homes will probably need 12-15 years for significant price increases to occur.
- In 1776 the colonies declared independence and signed a treaty called the Articles of Confederation but it wasn't until 13 years later faced with debt problems that they held a constitutional convention, formed the country and chose a president. In 1999 the Euro was introduced as the single currency for 17 European Union members but now, 13 years later,

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they must decide if they will form a federalist-type union that can collect taxes and issue debt, or not. Either way, they'll have a better system than the failed experiment they have now.

- Russia's upcoming entry into the World Trade Organization (WTO) will be a boon to economic growth in Europe.
- Lower energy prices will put dollars in consumer pockets helping consumer spending.
- Recent stock market declines make equities a more compelling investment than most bonds.

Our current investment strategy:

- Maintain higher than normal cash levels to buy securities on weakness opportunities.
- Panics are typically a good time to sell bonds and buy stocks, especially dividend payers. Timing is critical though as much can be lost in just 3 or 4 weeks. We will incrementally add to U.S. Equity holdings on sell-offs.
- Selectively add to oversold European stocks (German exporters, consumer staples, utilities).
- Use historical seasonal increases in Commodity prices in July-August to reduce allocation.
- Maintain current Gold allocation.
- Selectively increase U.S. Dollar allocation.
- Maintain current holdings in North American energy equities.
- Favor municipal (tax-free), corporate and inflation-protected bonds.
- Monitor hedge fund performance during market turmoil and replace if needed.
- If you want to buy your dream vacation home now is the time to do so.

Please note I will be out of the office from Monday, June 25th until Tuesday, July 3rd. I will be helping chaperone a troop of 8th / 9th grade boys on a missions and adventure trip to New Hampshire and Maine. I will definitely be out of touch! Thankfully, Steff will be here to provide service support. My partner, Thad O'Brien, will help with any investment related items that cannot await my return.

As always, I thank you for the privilege of helping you with your financial goals and decision making.

Sincerely,

Robert J. Boronski, MBA, CFP®

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