

THE PLANNING GROUP

A Wealth Management Firm

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Overview⁶

With so much doom and gloom being published these days, it's refreshing to hear a respected leader of a global, blue-chip company make a positive statement. Doug Oberhelman, the chief executive officer of Caterpillar, met with analysts last week and painted a rather bright picture of the world economy - "We don't think the world has ended."

Oberhelman went on to say that Caterpillar does not expect a double-dip recession because the world's central bankers are staying on top of the situation and the global economy is improving -- especially in the developing world. As the world's largest maker of construction and mining equipment, Caterpillar is considered a good indicator of worldwide economic health, according to Associated Press.

One question that many analysts and economists are struggling with is, "Can the world recover without the United States?" As the world's largest economy, there's an old saying that when our economy sneezes, the world catches a cold. Well, we've certainly done more than sneeze in the past three years. Optimists say that yes, the U.S. is still important in the world economy, but other countries, most notably China, India, and Brazil, can still prosper even if the U.S. is down for a few counts. Underscoring this idea of decoupling is the fact that China just passed Japan as the world's second largest economy, according to *The New York Times*. Forecasters are predicting that China will surpass the U.S. as the largest economy by as early as 2030.

Caterpillar, for one, thinks the world will continue recovering even if the U.S. is a bit weak. And the stunning growth of China makes that idea plausible.

Data as of 8/20/10	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	-0.7%	-3.9%	4.4%	-9.5%	-2.6%	-3.3%
DJ Global ex US (Foreign Stocks)	-0.5%	-5.5%	5.0%	-8.5%	1.2%	0.9%
10-year Treasury Note (Yield Only)	2.6%	N/A	3.4%	4.6%	4.2%	5.8%
Gold (per ounce)	0.8%	10.8%	30.1%	22.9%	22.7%	16.1%
DJ-UBS Commodity Index	-1.0%	-5.6%	4.3%	-6.7%	-4.4%	2.2%
DJ Equity All REIT TR Index	-0.5%	11.9%	35.2%	-6.0%	1.3%	10.1%

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

YOU MAY NOT HAVE HEARD OF STANLEY DRUCKENMILLER, but he will be remembered as one of the most successful investors (speculators?) of all time. Since 1986, Druckenmiller has generated average annual returns of 30%, according to an August 18 article by *Bloomberg*. Incredibly, in 30 years of managing money, he's never had a losing year.

Perhaps his most famous moment came in 1992 when he was working for famed investor George Soros. Together, they made a multi-billion dollar bet that the Bank of England would be forced to devalue the pound. Sure enough, that occurred and the duo made a \$1 billion profit for their investors -- in a single day.

When it comes to making money, Druckenmiller said, "It is not whether you are right or wrong that's important, but how much money you make when you're right and how much you lose when you're wrong." Last week, Druckenmiller announced that he was retiring from managing client money.

The fact that he was retiring was not unusual, rather, as it was the reasons he gave for the retirement. According to *The New York Times*, Druckenmiller said, "I have had to recognize that competing in the markets over such a long timeframe imposes heavy personal costs." He went on to say, "While the joy of winning for clients is immense, for me the disappointment of each interim drawdown over the years has taken a cumulative toll that I cannot continue to sustain."

Two days after Druckenmiller announced his retirement, another famous investor, Paolo Pellegrini, said he was getting out of the business of managing other people's money. Pellegrini is famous for betting against risky mortgages and helping his former boss, John Paulson, score a \$15 billion profit a few years back. This coup was chronicled in the bestselling book, *The Greatest Trade Ever*, by Gregory Zuckerman.

Why should you care that these two famous investors are exiting the business of managing other people's money? It's important because of the possible signal that it might be sending – but for the life of me, I'd be speculating as to what that signal might be.

The Economy⁷

The unemployment report jumped to its highest level since November 2009. New unemployment claims for the week hit 500,000. Vanguard's economist, Roger Aliaga-Diaz said, "When you surpass 500,000 in new applicants for unemployment insurance, that's usually a bad sign for the strength of the recovery." Generally numbers like that mean unemployment will remain high and therefore suggest consumer confidence will be low.

On the plus side, corporate performance and earnings have been better than most analysts had expected. Corporate earnings have increased for each of the past five quarters, and companies are flush with cash holding more than a trillion dollars in liquid funds on their balance sheets.

But as we have commented before, those gains have come primarily from reducing costs (jobs) rather than from increasing revenue or growth. Economic growth is weak and unemployment is still too high with many who have already, or about to exhaust the maximum number of weeks of unemployment benefits.

Most analysts are expecting the Republicans to gain ground over the Democrats. That makes the prospects of political gridlock in Washington another factor complicating the economic picture with the upcoming mid-term elections in November. So instead seeing more decisive action on a wide range of important issues (whether you agree with those issues or not) we are likely to see more political posturing on key issues such as taxation, federal estate tax, Medicare funding, and Social Security.

Interest rates continued to fall, when most thought it could not get much lower. Treasuries continued their slide to near-historic lows. I thought it was interesting that one commentator in today's *New York Times* calculated that the Fed's policy was costing savers about \$350 billion a

year in lost interest. The flip side is that is good news for people on the other side of that equation – the borrower (businesses and even the government).

So far in 2010, investors have withdrawn \$33.12 billion from domestic stock mutual funds, while bond funds have seen \$185.31 billion of inflow. Stock funds have seen net withdrawals for the last four years, while bond funds have had positive inflows during the last six years, and positive inflows for nine out of the past ten years.

Perhaps an obvious question is – “Is this a good time to be buying bonds?” In the short term – it is probably not a big deal as interest rates are likely to stay low due to our limping economy. However, in the future there are major clouds that hang over the horizon. As you know, bond prices and yields are inversely related; when one goes up, the other goes down, and vice versa. At some point interest rates will rise, and do so for a number of reasons. In a recent *Wall Street Journal*, Jeremy Siegel, Professor of Finance at the University of Pennsylvania, stated the following:

“Furthermore, the possibility of substantial capital losses on bonds looms large. If over the next year, 10-year interest rates, which are now 2.8%, rise to 3.15%, bondholders will suffer a capital loss equal to the current yield. If rates rise to 4% as they did last spring, the capital loss will be more than three times the current yield. Is there any doubt that interest rates will rise over the next two decades as the baby boomers retire and the enormous government entitlement programs kick into gear?”

I just finished reading the recently released study on the pension funds of the 50 states put out by *The Pew Center* (The Pew Foundation). It is discouraging to say the least, suggesting our state municipal pension plans are underfunded by about \$1 trillion as of 2008 (with it being even worse today). There were only four states that had pensions considered ‘well funded’. The worst state noted was Illinois having only 54% of its pension obligations currently funded (with an estimated unfunded pension obligations of \$80 billion and an additional \$40 billion in unfunded retiree health obligations). This report did not comment on municipalities other than state which all have similar issues facing them. We are going to be hearing a lot more about this subject in the future, and it will not be good news for the retirees.

Many are suggesting the only option available will be for municipalities to cut pension benefits where they can (without affecting contractual obligations), reduce the typical CPI increases retirees have enjoyed for so long, and increase the amount retirees contribute towards their health related benefits.

Additional Thoughts⁸

"Forgiveness does not change the past, but it does enlarge the future." ~Paul Boese

"It's never too late to have a happy childhood." ~Anonymous

Weekly Focus – Think About It

"If investing is entertaining, if you're having fun, you're probably not making any money. Good investing is boring." --George Soros

Best regards,

Reid Johnson and the Investment Team

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* You cannot invest directly in an index. The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. The DJ Global ex US is an unmanaged group of non-U.S. securities designed to reflect the performance of the global equity securities that have readily available prices. The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market. Gold represents the London afternoon gold price fix as reported by the London Bullion Market Association. The DJ Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998. The DJ Equity All REIT TR Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones.

⁶ The source for the information for *The Overview* was derived from Peak's *Weekly Commentary* 8/23/10

⁷ The source for the information for *The Economy* was derived from Bob LeClair's *Finance & Markets Newsletter* 7/31/10

⁸ Information for *Additional Thoughts* was derived from *The Virtual Advisor* 7/31/10.

* Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.

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