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## 2011 – A Year of Risk & Opportunity

This year marks the 3<sup>rd</sup> straight year of wildly mixed signals on the economic recovery and the direction of the financial markets. The 30 second “sound bites” and headline articles that we’re constantly bombarded with do not begin to examine risks of today’s global economic environment.

As many of you have heard me say, I believe major parts of our economy remain “broken”. Two weeks ago, Federal Reserve Chairman Ben Bernanke provided an upbeat economic outlook at the same time cautioning that the economy is still in a “deep hole”.

Most of what chairman Bernanke has been saying over the last 24 months sounds like it’s coming from a professional politician rather than a highly educated economist:

- He believes that the actions of the Federal Reserve to add an additional \$600 billion to the money supply (on top of the \$2 trillion that the Fed added in 2009) will not add to inflation and will allow the America to “spend its way” out of the recession by keeping interest rates low.

- He believes that the purposeful devaluation of our dollar by the Fed is not inflationary (The world’s principal commodities exchanges quote prices in dollars. Oil is priced in dollars. The dollar is used in 85% of all foreign exchange transactions worldwide.)

- Last week chairman Bernanke told the National Press Club luncheon in Washington, D.C. that there is no inflation in America and added that food & energy inflation trends have nothing to do with U.S. monetary policy. According to him, food & energy inflation is all about “supply & demand”. (Coca Cola – citing bills for juice, plastics & sweeteners, saw their cost of goods sold in October to December of last year increase 60%. Management has said that they will need to raise prices on beverages in the U.S. in 2011 as it faces \$300-\$400 million in cost increases from commodities. McDonald’s, Proctor & Gamble, and Sysco Foods have had similar comments.)

These kinds of statements and Federal Reserve policy actions are the kinds of things that make people really lose whatever trust they had left in government. I know that a vast majority of our clients are very concerned about the ultimate consequences our country will pay because of the actions of the Fed and the Treasury over the last two years.

What is really going on in our economy as we complete the 1<sup>st</sup> quarter of 2011? To be sure, corporate profits have been very good. Our corporations that do a majority of their business outside of this country have begun to show the beginnings of a solid rebound. Temporarily, the weak dollar and favorable credit conditions (low interest rates) have made a big difference in their bottom lines. This has led to a fair amount of talk & debate within the investment community if we are in a secular bull market (stocks continue to grow for another 3-6 years) or a cyclical bull market (stocks go up and then correct back to their lows until the economy becomes fundamentally healthy again).

On the other hand, unemployment, as measured by Gallup, increased to 10% in mid-February – up from 9.8% at the end of January – while the broader underemployment rate surged to 19.6%. New home sales dropped again last month as well as orders for long-lasting manufactured goods. Layoffs have fallen to pre-recession lows but new hiring isn't picking up appreciably. Banks are still very conservative when it comes to lending money to individuals and small business owners. Banks are being squeezed by increased regulations, higher loan reserve requirements and what is expected to be the worst year for home foreclosures since the housing bubble burst in 2008.

How to interpret the global picture is a bit trickier. Europe (Germany in particular) is showing signs of an economic rebound. China's economy is slowing somewhat but they are faced with a housing bubble that is more ominous than ours in 2008 and the Japanese in the 1980's. Ireland was forced to take "bailout" money by the Euro committee last fall in order to avert an Irish banking collapse. Portugal is the next domino to be toppled in the euro area's sovereign debt crisis. That will almost assuredly play out in 2011. Seems to me the "real wild card event" for 2011 is taking place right now in the Middle East. The social unrest in Egypt, Libya, Tunisia, Yemen & Oman (just to name a few) pose a significant potential threat to our economic recovery & possibly to global security. How do these events unfold & how will the world's financial markets react?

Once again, we're faced with significant challenges ahead. Without question, this current economic climate poses very real investment risks. At the same time, we believe there are investment opportunities as well.

But, now more than ever, there are looming questions that require important consideration and analysis. What will the stock market do? Will it continue to ignore domestic and international warning signs? Will there be a correction? Where's the best place for growth? What's ahead?

Difficult questions. No simple answers. Many believe we're facing uncharted territory - where the past is no longer a reliable barometer of what the future may hold.

The road ahead requires patience and perseverance. We're committed to separating fact from fiction in this economy. We will tell you like it is. No sugar-coating - just the honest and prudent analysis and advice you've come to expect from us over the years.

Together, we will continue to chart a course of action for you based on your specific needs. That includes listening to you and making recommendations based on balancing risk and reward.

We look forward to working with you. As always, if you have any questions or concerns, please contact us directly.

Sincerely,

*George*

George M. Kapusta, CFP  
President