

Ferguson Asset Management, Inc.

Financial Commentary and Portfolio Review

July 2011

April-June

The past quarter saw a mixed bag of returns for both the domestic and the international stock markets.

In spite of the budget stalemate, 9.2% unemployment, ongoing foreclosure issues, Murdoch, Italy, Greece, Spain, Casey, Afghanistan, heat wave, drought, Libya, the National Debt, China, twitter, and the Arab Spring, the world's stock markets closed fairly close to even last quarter. Some were off a percent or two and some were up a tad, but there was no carnage, as many prognosticators had forecast.

Market timers got whipsawed when an early quarter rally sputtered into a 7% decline (based on the S&P 500 Index) and then partially recovered the last three days of June. Sticking to one's long term allocation plan has been the key to successful investing for decades.

In a recent quarterly report, we included a graph showing that the performance of the S&P 500 Index had an annualized compound return of 9.87% from January 1, 1970 through December 31, 2009. But, if one missed the 5 best single days, the return on their investment was 34% lower.

If you and your neighbor both started 1970 with a \$100,000 investment in the S&P 500, and they missed the 5 best days, their portfolio would only have been worth \$280,360 versus your \$431,190. They would have wondered how come you were able to take a European jaunt when they felt strapped.

Looking further into those missed days, we find that three of the five worst days in the past 60 years occurred in 2008, and that three of the five best days also occurred in 2008. It takes discipline to maintain a prudent course of action and not be swayed by all the media noise and historically ongoing economic uncertainty.

Interest Rates and Equity Returns

During the past 20 years the one-year Treasury Yield Curve Rate on the first of July averaged 3.927%. Someone with a \$100,000 Treasury would have realized an average \$3,900 + annualized return. The yield this July 1, 2011 on the one-year Treasury is 0.20%. That translates into a \$20.00 (twenty bucks!) annualized return. The ten-year Treasury has fared a little better, as the current return is down only 40% from the twenty-year average return.

The little old ladies and little old men who wanted safe investments have seen their returns plummet. They are in a quandary. Worse, if they buy longer-term bonds and rates rise, their principal will take a big hit.

As investors, we are normally asking ourselves, “How am I doing financially?” We compare the potential returns of various investments. Back in 1980-81, the ten-year Treasury reached a yield in excess of 14%. During the housing boom of the early 2000’s, prices were advancing in excess of 20% a year in many locals. During those periods we wanted or expected our total investment returns to have a favorable comparison.

We certainly don’t want to compare returns to the 1/5th of 1% that the Treasuries return. The Bureau of Labor Statistics most recent data (12-month based) indicates that our current inflation rate is 3.6%. The owner of a one-year Treasury is losing 3.4% to inflation and the ten-year holder is losing 0.38%, and that is before their tax bill.

Perhaps the historical stock market annualized returns of 10-11% are gone for some time. Pity, because some pension and government retirement plans funding assumptions were based on those prior period returns. This is just one reason why so many state and local governments are in a financial debacle. They have unfunded pension liabilities that they can’t possibly make up without significant tax increases and spending cuts.

In our retirement and financial planning models we run projections on 4-5-6-and 7% returns. If our analysis shows you can have a comfortable retirement at those levels, then a higher return is just frosting on your cake. Sometimes our planning shows you need to work a few more years or cut back on your retirement goals. We don’t want our clients to be unpleasantly surprised in their later years. We want you to be ahead of the game.

Our Group of Twenty

We are a very cohesive internal team of four. Among us we have nearly 90 years of investment experience. We operate as a team here. We all know what our client allocations are and what your investment policy is. We know how old you are, the status of your health, and your plans for you and your family. We are a tight knit group without any infighting, but we do have serious discussions about the markets, allocations, and your needs and wants. But, we are more than just the four of us.

We have a dedicated client service manager at Fidelity, and he has a team behind him. They can cut through most any questions we have and give us timely answers on retirement, forms required, tax related, or numerous other questions we might have. We have a bond trader who handles our needs at Fidelity, and a technical department to keep us posted on this ever changing area. We are on Fidelity’s invitation list for VIP conferences and enjoy their dedication to serving us.

Dimensional, whose engineered indices we prefer as our core holdings, also has a dedicated counselor, with a degree from Georgetown University, to provide us needed service. Axys, our portfolio record keeping system gives us assistance for our technical support. We have attorneys for estate work, tax and corporate needs, and even a defense attorney on our roster.

If we need accounting advice or an enrolled IRS agent we have them, and special insurance needs are only a phone call away, both for health, life, and annuity needs. We have connected our clients with multi-million dollar mortgage financing and small interim loans. The real estate agents we use are experienced professionals, for whom we have received accolades from our clients.

We think of ourselves as your core contact for numerous professional services. We are a group of at least twenty at your service.

The Planning Corner

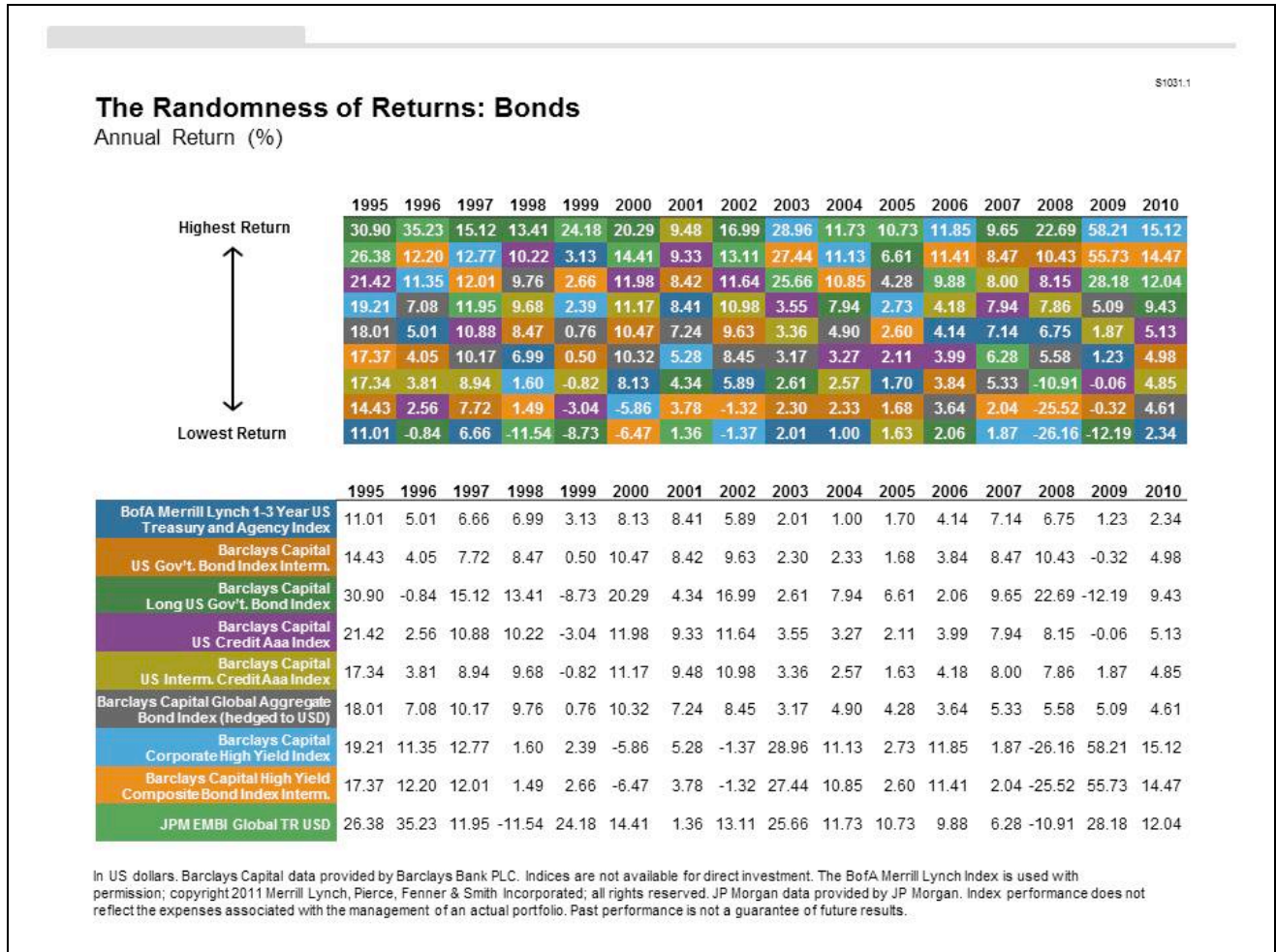
One of the important planning issues we guide our clients through is investment of inherited wealth. Recently, we've had a number of clients working through the myriad of issues that may arise when receiving an inheritance. Fortunately, many times an inheritance comes in the form of a qualified or Individual Retirement Account (IRA). This type of asset is advantageous, as it allows the benefit of tax-deferred growth so long as the investments remain in the account. A few considerations apply when inheriting qualified money:

- **Keep your inheritance in an Inherited IRA.** (called a Beneficiary IRA or IRA BDA account.) By doing so you are preserving the tax deferred status. If the estate were to distribute the funds directly to you, a substantial tax bill would follow. This is especially true if you are still working. An inheritance can even place you in a higher tax bracket!
- **Take your Required Minimum Distributions.** Once the funds are in an IRA BDA account, the IRS requires an annual minimum distribution. The calculation can be somewhat confusing and many people just don't want to deal with it. However, the IRS penalty for not taking the correct amount is a whopping **50%** of the required withdrawal.
- **Managing your own estate plan.** We have seen firsthand what improper estate planning can do. Assets intended for beneficiaries end up in that state's coffers, either because of death without a will, or substantial taxes from sub-optimal planning. Estate planning is complicated and requires careful coordination and consideration of many factors.

Our team is here to assist you in managing all aspects of your wealth, including your use, investment, and planning for sudden wealth you may receive. Please call on us anytime if you have questions or if you anticipate receipt of additional funds.

The Randomness of Returns: Bonds

The following graph shows that bond markets around the world do not behave consistently or predictably, which is one reason we diversify across global markets. Notice the huge disparity between the best and worst returns in 2009.



Enjoy your summer.

John, Derek, Dawn, and Sue