



## Johnston Investment Counsel

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Market-Moving Indicators for Monitoring Europe

New 401(k) Plan Disclosure Rules

Ways Parents Can Help Their Boomerang Kids

Can I convert my traditional IRA to a Roth IRA in 2012?



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## Market-Moving Indicators for Monitoring Europe

If you've struggled to make sense of the ongoing European debt debacle, you're not alone. It's difficult even to keep track of all the pieces of this financial Rube Goldberg puzzle, let alone understand how they can influence one another.

Though new aspects of the situation seem to crop up every month, here are some of the most common factors that either reflect or affect sentiment about what's happening in Europe. Knowing about them might help you understand why markets react to a seemingly obscure headline. After all, one of the few things that almost everyone seems to agree on is that the situation isn't likely to be solved overnight.

### Take an interest in interest rates

Interest rates on sovereign debt are perhaps the most closely watched indicator. When demand for a country's bonds is low because investors are concerned about the possibility that they might not be repaid in full and on time, that country must offer a higher interest rate in order to borrow money to finance its day-to-day operations.

Interest rates become particularly worrisome when they reach or exceed 7%. That's the level that prompted Greece, Ireland, and Portugal to seek bailouts from their European peers, and it's widely seen as unsustainable. When a country must pay that much simply to service its debt, investors become concerned that high borrowing costs will make a country's financial situation even worse.

### Watch credit ratings

Troubled European countries are struggling to deal with a devilish Catch-22. In many cases, unsustainable debt burdens have led to stringent austerity measures; however, such measures also can hamper economic growth, which reduces tax revenue and can potentially increase deficits. Higher deficits can lead to a lower credit rating that in turn can mean higher borrowing costs, bringing on the problems discussed above and potentially launching a new downward economic cycle. Thus, a downgrade to a country's credit rating tends to raise concerns.

However, investor reaction also can be unpredictable. For example, Standard & Poor's January downgrade of nine sovereign nations and the European Financial Stability Fund was largely met with a shrug by investors. There's been so much pessimism about Europe for so long that in some cases, markets may already have priced in much of the bad news.

### Monitor credit default swap costs

A credit default swap (CDS) is a form of insurance against the possibility that a bond issuer might default or fail to make a payment on its obligations. Bondholders buy a CDS from a financial institution or insurance company that promises to reimburse the bondholder for any losses sustained in the event of a default. The cost of that insurance is seen as a proxy for the perceived risk involved in investing in a particular country's bonds. The higher the cost of a CDS on, say, Italian sovereign debt, the greater the anxiety about whether the bond issuer will default and the CDS issuer will have to pay.

### Follow the money

To prevent credit markets from seizing up, the European Central Bank late last year provided almost €500 billion in three-year loans to European banks, making it easier for them to refinance their debt. The level of borrowing at the ECB is seen as one indicator of how banks are being affected by their holdings of sovereign debt. The greater the need to borrow from the ECB, the greater the banks' perceived level of vulnerability.

### Bailouts: Nein nein nein?

U.S. voters aren't the only ones who are sensitive about bailouts; so are Germans. As Europe's most powerful economy and the one with the best credit rating, Germany is the tentpole upon which European financial stability hangs. However, by the end of 2011, the German economy had begun to slow. Any indications that economic pressure could threaten Germany's ability and willingness to remain strong in its support of the eurozone can spook anxious investors.



*In October 2010, the Department of Labor issued new regulations that require all self-directed 401(k) plans--both those that choose to comply with ERISA Section 404(c) and those that do not--to provide the same detailed information to participants about the plan and its investments, on a regular and periodic basis, so that participants can make informed decisions with regard to the management of their individual accounts.*

## New 401(k) Plan Disclosure Rules

You may have heard about new disclosure rules that will soon apply to 401(k) plans. Before describing what's ahead, however, a look back may be helpful. (While we'll refer to 401(k) plans in this article, the new rules also apply to other employer-sponsored plans that allow participants to direct their own investments, commonly referred to as "self-directed plans.")

### Background

Most 401(k) plans are governed by the Employee Retirement Income Security Act of 1974 (ERISA) (governmental plans, owner-only plans, certain 403(b) plans, and certain church plans are not). One of the primary reasons Congress enacted ERISA was to protect retirement plan assets, and one of the important ways ERISA does so is through its rules governing the conduct of plan fiduciaries.

In general, plan fiduciaries include the plan administrator, anyone providing investment advice for a fee, and anyone who exercises discretionary authority or control over the plan or the plan's assets. Plan fiduciaries must discharge their duties with respect to the plan prudently, and solely in the interest of participants and beneficiaries.

A fiduciary who breaches his or her duty to the plan may be personally liable for any losses that occur as a result of that breach. The investment of plan assets is a fiduciary act governed by ERISA's fiduciary standards.

### Section 404(c) plans

But who is responsible for losses in a self-directed plan, where the participants themselves, and not the plan sponsor or an investment manager, select the investments for their retirement accounts? To answer this question, in 1992 the Department of Labor (DOL) issued regulations that allow 401(k) plan fiduciaries to avoid responsibility for losses in self-directed plans that occur as a result of a participant's exercise of investment control over his or her own account, if specific requirements are satisfied.

To avoid liability, self-directed plans must provide participants with a diversified choice of investments, and must disclose very specific information about the plan and its investments (and comply with certain other requirements). While these rules are voluntary, many (if not most) 401(k) plans choose to comply, in order to shift liability for losses away from the plan's fiduciaries.

A 401(k) plan that complies with these rules is

known as a "Section 404(c) plan," after the section of ERISA that governs self-directed plans. A plan's summary plan description (SPD) should indicate if the plan intends to be a Section 404(c) plan.

### What's changing?

As self-directed plans have grown more popular, the DOL has become increasingly concerned that participants might not have access to, or might not be considering, information critical to making informed decisions about the management of their accounts--particularly information about investment choices, fees, and expenses.

As a result, in October 2010, the DOL issued new regulations that require all self-directed 401(k) plans--both those that choose to comply with Section 404(c) and those that do not--to provide the same detailed information to participants about the plan and its investments, on a regular and periodic basis, so that participants can make informed decisions with regard to the management of their individual accounts.

Some information must be provided on an annual basis, and some information must be provided quarterly. For calendar year plans, the initial annual disclosure must be furnished no later than August 30, 2012. The first quarterly statement must be furnished no later than November 14, 2012 (for July through September 2012).

Participants in 401(k) plans that comply with ERISA Section 404(c) are already receiving most of the information required by the new regulations. In general, more detailed information about investment fees and expenses must now be disclosed to participants.

Another change is that plan investment information must now be provided in chart form, so that participants are better able to compare investment alternatives. And plans will no longer be required to automatically provide a prospectus to participants, although one must be provided upon request.

### Which plans must comply with the new rules?

These new disclosure rules apply to 401(k) plans and other plans that allow participants to direct their own investments, but they don't apply to IRAs, SEPs, or SIMPLE IRA plans. They also don't apply to plans that aren't covered by ERISA.



## Ways Parents Can Help Their Boomerang Kids



### A financial strain

*Parents naturally want to help their children during hard times, but in some cases, the financial strain of another adult (or two or three) in the house can be too much of a financial shock. If your adult child needs to move back home, discuss how long your child plans to stay and how he or she can contribute financially to the household.*



It's been called the new retirement wild card. But it's not inflation, health-care costs, or taxes, though those things certainly matter. What is it that's causing so much uncertainty? It's boomerang kids, and the money their parents spend on them.

### The trend

According to the U.S. Census Bureau, there were 6 million young adults ages 25 to 34 living at home in 2011--19% of all men (up from 14% in 2005) and 10% of all women (up from 8% in 2005). Not surprisingly, the percentages are higher for young adults in the 18 to 24 age bracket, with 59% of young men and 50% of young women living with their parents in 2011.

Sociologists have cited a number of reasons for this trend--the recession, college debt, the high cost of housing, delayed marriage, and a tendency toward prolonged adolescence. But whatever the reason, there's no doubt that boomerang children can be a mixed blessing for their parents, both emotionally and financially. Just when parents may be looking forward to being on their own and preparing for their retirement, their children are back in the nest and relying on their income. While the extra company might be welcome, you don't want to sacrifice your emotional and financial health to help your kids.

### Set ground rules

If your adult children can't afford to live on their own, establish ground rules for moving back home, including general house rules, how long they plan to (or can) stay, and how they can contribute to the household in terms of rent and chores. As an adult, your child should be expected to contribute financially to the household overhead if he or she is working. Determine a reasonable amount your child can contribute toward rent, food, utilities, and car expenses. You can then choose to apply this money directly to household expenses or set it aside and give it to your child when he or she moves out, when it can be used for a security deposit on an apartment, a down payment on a car, or some other necessary expense.

You should also discuss your child's long-term plan for independence. Does your child have a job or is he or she making sincere efforts to look for work? Does your child need or want to go back to school? Is your child working and saving money for rent, a down payment on a home, or graduate school? Make sure your child's plans are realistic and that he or she is taking steps to meet those goals.

It's a balancing act, and there isn't a road map or any right answers. It's common for parents to

wonder if they're making a mistake by cushioning their child's transition to adulthood too long or feel anxious if their child isn't making sufficient progress toward independence.

### Turn off the free-flowing money spigot

It can be tempting for parents to pay all of their adult children's expenses--big and small--in an effort to help them get on their feet, but doing so is unlikely to teach them self-sufficiency. Instead, it will probably make them further dependent on you.

If you can afford it, consider giving your child a lump sum for him or her to budget rather than just paying your child's ongoing expenses or paying off his or her debt, and make it clear that is all the financial assistance you plan to provide. Or, instead of giving your child money outright, consider loaning your child money at a low interest rate. If you can't afford to hand over a sum of cash or prefer not to, consider helping with a few critical expenses.

Evaluate what your money is being spent on. A car payment? Credit card debt? Health insurance? A fancy cell phone? Student loans? General spending money? Your child is going to have to cut the frills and live with the basics. If your child is under age 26, consider adding him or her to your family health plan; otherwise, consider helping him or her pay for health insurance. Think twice about co-signing a new car loan or agreeing to expensive lease payments. Have your child buy a cheaper used car and raise the deductible on his or her car insurance policy to lower premiums. Help your child research the best repayment plan for student loans, but don't pay the bills unless absolutely necessary. Same goes for credit card balances. Have your child choose a less expensive cell phone plan, or consolidate phones under a family plan and have your child pay his or her share. Bottom line--it's important for your child to live within his or her financial means, not yours.

### Solidify your own retirement plan

Even if your child contributes financially to the household, you may still find yourself paying for items he or she can't afford, like student loans or medical bills, or agreeing to pay for bigger ticket items like graduate school or a house down payment. But beware of jeopardizing your retirement to do this--make sure your retirement savings are on track. A financial professional can help you see whether your current rate of savings will provide you with enough income during retirement, and can also help you determine how much you can afford to spend on your adult child now.



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## Can I convert my traditional IRA to a Roth IRA in 2012?

It may be an excellent time to consider converting your traditional IRA to a Roth IRA. As a result of market volatility, some investors have seen a reduction in the value of their traditional IRAs, meaning that the tax cost of converting may have dropped significantly. Also, federal income tax rates are scheduled to increase in 2013, so converting this year may be "cheaper" than converting next year.

Anyone can convert a traditional IRA to a Roth IRA in 2012. There are no longer any income limits, or restrictions based on your tax filing status. You generally have to include the amount you convert in your gross income for the year of conversion, but any nondeductible contributions you've made to your traditional IRA won't be taxed when you convert. (You can also convert SEP IRAs, and SIMPLE IRAs that are at least two years old, to Roth IRAs.)

Converting is easy. You simply notify your existing IRA provider that you want to convert all or part of your traditional IRA to a Roth IRA, and they'll provide you with the necessary paperwork to complete. You can also transfer or roll your traditional IRA assets over to a new

IRA provider, and complete the conversion there.

If a conversion ends up not making sense (for example, the value of your Roth IRA declines after the conversion), you'll have until October 15, 2013, to "recharacterize" (i.e., undo) the conversion. You'll be treated for federal income tax purposes as if the conversion never occurred, and you'll avoid paying taxes on the value of IRA assets that no longer exist.

The conversion rules can also be used to allow you to contribute to a Roth IRA in 2012 if you wouldn't otherwise be able to make a regular annual contribution because of the income limits. (In 2012, you can't contribute to a Roth IRA if you earn \$183,000 or more and are married filing jointly, or if you're single and earn \$125,000 or more.) You can simply make a nondeductible contribution to a traditional IRA, and then convert that traditional IRA to a Roth IRA. (Keep in mind, however, that you'll need to aggregate the value of all your traditional IRAs when you calculate the tax on the conversion.) You can contribute up to \$5,000 to an IRA in 2012, \$6,000 if you're 50 or older.



## Can I undo my Roth IRA conversion?

When you convert a traditional IRA to a Roth IRA, you include the value of your traditional IRA, reduced by any nondeductible contributions you've made, in income for federal tax purposes in the year of the conversion. But what happens if the value of your Roth IRA subsequently declines, making the conversion a bad deal from a tax perspective? No problem. The IRS lets you recharacterize (undo) a conversion, if you act in a timely fashion.

For example, assume you convert a fully taxable traditional IRA worth \$50,000 to a Roth IRA in 2012. You include \$50,000 in income on your 2012 federal income tax return. But shortly after the conversion, the value of your Roth IRA declines to \$25,000. Now you're suddenly faced with the proposition of paying taxes on \$50,000, while your Roth IRA is worth only \$25,000.

All is not lost—because of the recharacterization rules, you have until your tax return due date (including extensions) to undo all or part of a conversion if it no longer makes good financial sense. So in this example, you have until October 15, 2013, to recharacterize. (Similarly,

if your conversion occurred in 2011, you have until October 15, 2012, to undo the conversion.)

When you recharacterize, you need to withdraw the amount you originally converted, plus any earnings, out of the Roth IRA and transfer it back to a traditional IRA. To simplify the calculation of earnings if you decide to recharacterize, you should consider using a new Roth IRA for each conversion. You might also consider using a different Roth IRA for each separate investment, or class of investments, you plan to make—this way, if one investment goes down but another goes up, you can recharacterize only the Roth IRA that declined in value (you don't need to aggregate your Roth IRAs for this purpose). If you wish, you can always combine Roth IRAs later after the recharacterization deadline passes.

If you convert a traditional IRA to a Roth IRA in 2012 and then recharacterize, you'll have to wait until January 1, 2013, to reconvert those same dollars (and any earnings) to a Roth (or, if later, the 31st day following the recharacterization). However, any other traditional IRA dollars you have can be converted to a Roth IRA without restriction.



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# Capital Market Review

*Second Quarter, 2012*

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## Summary

Global economic activity is, once again, slowing. The fiscal troubles in Europe's peripheral countries have now expanded to Spain and Italy. Austerity measures will affect future economic growth for years to come. China's economy, which exports 8% of its GDP to Europe (the U.S. exports 3%) has significantly slowed and is starting to implement pro-growth policies. The U.S., for the third consecutive year, has entered its summer economic slowdown.

U.S. growth is dangerously slow at about 2%. Businesses are in strong financial shape. But with the sting of 2008 still fresh in executives' minds coupled with extreme uncertainty around Europe (will the Euro survive?) and the impending U.S. "fiscal cliff", we understand why executives are striking a cautious tone.

Stock markets did not react well to Europe's latest troubles but rallied late in the quarter. U.S. stock market returns were -3.2% for the second quarter and 9.3% year-to-date. The U.S. investment grade bond market continued to perform well, up 2.1% for the quarter.

We expect heightened volatility during the coming months.

## **Economic Conditions**

Global economic activity is slowing. Significant weakness in Europe's peripheral nations are affecting economic growth for the core countries and major emerging market economies. China's economy, which is estimated to have 8% of its GDP exported to Europe, has significantly slowed and has implemented fiscal and monetary measures to try and restore growth. For the third consecutive year, the U.S. has entered its summer economic slump.

Greece may have been the spark that started Europe's financial crisis, but the more significant issues are with Spain and Italy. Due to a falling real estate market, Spanish banks are in financial trouble. Because European banks hold each other's debt, falling asset prices in a country the size of Spain impacts the banking system of many countries. As the solvency of each country's banking system gets brought into question, what started out as a private sector problem, morphs into a sovereign debt problem. Europe is in need of a "big bang" plan that addresses the banking system, sovereign debt, governance, and growth. It is difficult to see a way out without some sort of fiscal union. However, the political calculus necessary to make a fiscal union a reality is incredibly difficult.

Assuming the Euro-zone stays together, the shorter-term liquidity problems may be averted by European Central Bank actions. However, the underlying solvency problems are nowhere near fixed. The austerity measures being implemented throughout Europe will reduce economic growth expectations for years. In fact, as these policies begin to impact citizens that vote, one cannot underestimate the political implications (France has already elected a socialist president) and the staying power of any reforms.

The U.S. economy is growing but at a dangerously slow pace. Real GDP is expanding no faster than 2% at an annual rate and recent employment gains have been poor. Unless job growth improves, the unemployment rate will probably remain above 8% for some time.

The U.S. economy is not overly reliant on exports to Europe (about 3% of U.S. GDP). In fact, changes in the price of gasoline are more likely to have a more material impact on U.S. GDP. Regardless, while the direct links may be relatively small, the uncertainty and indirect links are significant as many major U.S. companies generate a meaningful amount of their revenue and profit from Europe.

Business managers do not know how to handicap a

breakup of the Euro-zone and what it means for their business, customers, vendors, and the trail-off effects. With memories of the 2008 recession still fresh and, given the European and U.S. fiscal cliff uncertainty, it is understandable that business managers are being cautious with respect to hiring and growth plans.

The U.S. fiscal cliff has to do with two issues that occur at the end of this year -- the Bush era tax cuts expire and significant spending cuts are implemented to reduce the size of the deficit. If implemented, short-term economic growth would be impacted. An economy growing at just barely 2% probably could not withstand the shock and would likely slip into a mild recession. That short-term cost must be balanced against the longer-term benefits of starting to put our fiscal house "in order". Our policymakers will probably focus on the short-term (easy) approach and, after the election, will take action to delay some (or all) of the tax increases and reduce some (or all) of the spending cuts. In essence, kick the can down the road -- again.

At present, the recovery from the "Great Recession" continues, but at an extremely disappointing and frustratingly slow pace. Given the uncertainty around Europe and our own economic policies, it is quite clear that economic risks are heightened and are skewed to the downside.

## **Stock Market**

For most of the second quarter, the stock market did not react well to the uncertainty and news around the European and U.S. economic situation. But, thanks to an end of the quarter rally, the losses were reduced.

During the second quarter, U.S. stocks returned -3.2%, developed international stocks returned -7.1%, and emerging market stocks returned -10.0%. Year-to-date, all three markets are in positive territory (thanks to strong first-quarter returns), with U.S., developed market, and emerging market stock returns of 9.3%, 3.0%, and 2.3%, respectively.

Large-cap stocks have outperformed mid-and small stocks for both the second quarter and on a year-to-date basis. More specifically, large stocks have returned 9.4%, small stocks 8.5%, and mid stocks 8.0% for the first two quarters of the year.

Growth stocks did not outperform value stocks during the second quarter (-4.0% vs. -2.3%), but they have on a year-to-date basis returning 10.0% versus the value stock return of 8.6%.

Only three sectors produced positive returns during the second quarter -- telecommunications at 14.1%, consumer staples at 2.9%, and healthcare at 1.8%. Finance, technology, and energy sectors were the worst performing sectors with returns between -6.0% and -6.8%. On a year-to-date basis, telecommunication, finance, technology, and consumer discretionary sectors all have returns above 13% while the energy sector is the only sector with a negative return of -2.3%.

After the poor performance of emerging market stocks during the second quarter, their valuations became more competitive. The long-term growth story of emerging markets is still intact. However, since many of them are still export-driven, economic concerns in Europe and the U.S. remain a headwind. Regardless, longer-term investors may find the next few months a reasonable time to establish (or increase) a position.

Here in the U.S., 2012 earnings growth expectations have been significantly reduced (but we believe have further to fall -- particularly for mid and small-cap stocks). While forecast earnings growth of large stocks is not as high as mid and small-cap stocks, neither are the valuations. Overall, we believe the stock market is slightly undervalued. We believe this undervaluation is primarily concentrated in large-cap stocks.

Recent events in Europe and at home have, once again, raised the level of uncertainty around the stock market's short-term direction. It is entirely possible that stocks could get much cheaper before they start to appreciate. This brings us to the topic of volatility.

In recent years, the market has become more volatile than in the past. Between 1982 and 2007, the volatility of the S&P 500 was approximately 15%. Since 2008, volatility has increased to near 25%. While no single explanation fully captures the reasons for the increase, many believe increases in economic volatility are a major contributor.

Since 2008, developed market economic volatility has increased by several different measures. Many attribute this to the lingering impact of the financial bubble and accompanying deleveraging. This deleveraging is creating economic headwinds leading to less stable economies and more volatile markets. Unfortunately, it will likely take years for the deleveraging process to be "completed". We expect economic volatility to be above normal for the next several years and perhaps through the remainder of the decade.

## **Bond Market**

During the second quarter, bond returns were positive as interest rates, generally speaking, declined. The U.S. bond market returned 2.1% while developed and emerging market bonds returned 0.5% and 2.8%, respectively. Year to date, U.S. bonds returned 2.4%, emerging market bonds 7.1%, and developed international bonds -0.3%. High-yield bonds returned 1.8% during the second quarter and 7.3% for the first half of 2012.

The quality spread (difference between Baa and ten-year treasury yields) increased during the quarter in direct response to increased economic concerns. The maturity spread (difference between the 10- and one-year maturity) narrowed during the quarter as yields on the 10 year bond fell by more than the yield on the one-year bond. Similar to the quality spread, the maturity spread can also be thought of as an indicator of future economic activity -- wider spreads imply higher expected economic growth.

Treasury yields remain extremely low and are below the rate of inflation for essentially all maturities except the 30 year bond. This condition is expected to exist for at least the foreseeable future. Investors should be careful in reaching for too much yield as higher yields generally indicate more risk in the underlying bonds.

## Stock Returns For Periods Ending June 30, 2012

	<u>Qtr</u>	<u>Ytd</u>	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>		<u>Qtr</u>	<u>YTD</u>	<u>1 Year</u>
<b>Nationality</b>						<b>Developed Country</b>			
U.S. Market	-3.2	9.3	3.8	16.7	0.4	U.S.	-3.2	9.3	3.8
Developed Intl	-7.1	3.0	-13.8	6.0	-6.1	Canada	-8.3	-2.9	-19.4
Emerging Market	-10.0	2.3	-18.2	7.2	-2.4				
<b>Size</b>						<b>Europe</b>			
Large	-3.1	9.4	4.4	16.6	0.4	France	-11.0	-0.3	-29.9
Mid	-4.4	8.0	-1.7	19.4	1.1	Germany	-14.6	2.9	-27.2
Small	-3.5	8.5	-2.1	17.8	0.5	Italy	-14.4	-6.8	-37.2
Micro	-1.6	16.7	2.7	18.7	-0.1	United Kingdom	-5.1	1.1	-9.3
<b>Approach</b>						<b>Pacific</b>			
Value	-2.3	8.6	2.6	15.9	-2.1	Australia	-6.0	1.1	-15.5
Core	-3.2	9.3	3.8	16.7	0.4	Hong Kong	-6.4	5.8	-11.4
Growth	-4.0	10.0	5.1	17.6	2.8	Japan	-7.4	2.0	-11.0
<b>Sector</b>						<b>Emerging Market</b>			
Cons Discretionary	-2.6	13.0	10.7	25.8	3.9	China	-7.7	1.4	-18.7
Cons Staples	2.9	8.6	14.7	18.2	8.4	India	-10.2	7.5	-26.1
Energy	-6.0	-2.3	-8.2	12.7	0.9	Korea	-8.7	4.4	-15.2
Finance	-6.8	13.7	-2.7	8.7	-14.6	Czech Republic	-15.3	-7.5	-31.3
Healthcare	1.8	11.0	9.8	15.4	3.7	Hungary	-10.4	9.9	-38.7
Industrials	-3.6	7.4	-1.2	20.2	-0.2	Poland	-7.2	9.1	-32.2
Technology	-6.7	13.3	13.7	18.3	4.6	Russia	-16.9	-1.5	-28.7
Materials	-4.2	6.5	-7.2	15.3	-0.1	Brazil	-20.0	-9.5	-29.7
Telecomm	14.1	16.5	15.6	18.7	1.6	Mexico	-1.9	13.2	-0.9
Utilities	6.6	4.8	15.3	14.7	2.9	Mexico			

## Stock Fundamentals As Of June 30, 2012

	<u>United States</u>		<u>Developed</u>		<u>Emerging</u>					
	<u>Current</u>	<u>1 Year Ago</u>	<u>Current</u>	<u>1 Year Ago</u>	<u>Current</u>	<u>1 Year Ago</u>				
Price/Earnings Current	14.3	15.5	10.4	12.9	9.5	13.1				
Price/Forecast Earnings	13.2	14.3	10.5	11.6	9.9	11.9				
Price/Book	2.0	2.2	1.2	1.5	1.5	1.7				
Price/Cash Flow	8.6	9.8	6.0	6.9	6.5	7.4				
Price/Sales	1.2	1.3	0.7	0.9	0.98	1.30				
Forecast LT EPS Growth	10.6	10.3	8.9	7.9	12.4	16.1				
	<u>Est. P/E Ratio</u>		<u>Est. EPS Growth</u>		<u>2012 Fair Value Returns</u>			<u>2013 Fair Value Returns</u>		
	<u>2012</u>	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>13x</u>	<u>17.5x</u>	<u>7% DR</u>	<u>13x</u>	<u>17.5x</u>	<u>7% DR</u>
Large	13.2	11.6	6.8	14.0	-1.7	32.4	8.1	12.1	51.0	23.2
Mid	15.8	13.3	18.6	18.9	-17.6	10.9	-9.5	-2.1	31.8	7.6
Small	17.8	13.9	21.8	27.8	-26.8	-1.5	-19.6	-6.5	25.9	2.8



## Bond Returns And Characteristics For Periods Ending June 30, 2012

	<u>Returns</u>					<u>U.S. Bond Yields</u>	<u>Last</u>	<u>1 Year</u>	
	<u>Qtr</u>	<u>Ytd</u>	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>		<u>Qtr</u>	<u>Qtr</u>	<u>Ago</u>
<b>Nationality</b>						Fed Funds	0.16	0.13	0.09
U.S. Market	2.1	2.4	7.5	6.9	6.8	Prime Rate	3.25	3.25	3.25
Developed Intl	0.5	-0.3	1.0	5.8	8.0	3 Month Treasury	0.09	0.08	0.04
Emerging Market	2.8	7.1	9.8	13.1	9.2	1 Year Treasury	0.19	0.19	0.18
						3 Year Treasury	0.39	0.51	0.71
						5 Year Treasury	0.71	1.02	1.58
<b>Maturity</b>						5 Year TIP	-1.05	-1.03	-0.38
Cash	0.0	0.0	0.1	0.1	0.8	10 Year Treasury	1.62	2.17	3.00
Short-Term	0.2	0.6	1.1	2.3	3.7	30 Year Treasury	2.70	3.28	4.23
Intermediate-Term	1.5	2.1	5.4	5.8	6.0	Aaa Corporate	3.64	3.99	4.99
Long-Term	7.3	5.0	24.6	14.4	11.0	Baa Corporate	5.02	5.23	5.75
<b>Sector</b>						Barclays Aggregate	2.58	2.82	3.39
Corporate	2.5	4.6	9.5	10.1	7.6	Barclays Credit	3.81	4.01	4.40
Government	2.6	1.5	8.3	5.7	6.6	Barclays Treasury	1.76	1.84	1.97
Mortgage	1.1	1.7	5.0	5.4	6.7	Barclays Mortgage	2.95	3.27	3.33
						Barclays Municipal	3.10	3.25	3.44
<b>Other</b>						Barclays High Yield	7.28	7.32	8.25
High Yield	1.8	7.3	7.3	16.3	8.5	Citi Intl Treasury	3.78	4.03	2.36
Inflation Protected	3.2	4.0	11.7	9.6	8.4	JPM Emerging	4.62	4.72	5.00
Municipal	1.9	3.7	9.9	7.6	6.0				

### 10-Year Sovereign Bond Yields

### Spreads Versus 10-Year Treasury

<u>Developed Mkts</u>	<u>Qtr</u>	<u>Last</u>	<u>1 Year</u>		<u>Qtr</u>	<u>Last</u>	<u>1 Year</u>
		<u>Qtr</u>	<u>Ago</u>			<u>Qtr</u>	<u>Qtr</u>
United States	1.62	2.29	3.14	Aaa	2.02	1.82	1.99
Canada	1.73	2.24	3.08	Baa	3.40	3.06	2.75
France	2.66	3.01	3.39	Barclays Aggregate	0.96	0.65	0.39
Germany	1.55	1.97	2.98	Barclays Credit	2.19	1.84	1.40
Italy	6.21	4.99	4.95	Barclays Treasury	0.14	-0.33	-1.03
United Kingdom	1.75	2.47	3.24	Barclays Mortgage	1.33	1.10	0.33
Euro Zone	1.55	1.97	2.99	Barclays Municipal	1.48	1.08	0.44
Australia	2.97	4.39	5.19	Barclays High Yield	5.66	5.15	5.25
Hong Kong	1.02	1.50	1.96	Citi Intl Treasury	2.16	1.86	-0.64
Japan	0.81	1.03	1.10	JPM Emerging	3.00	2.55	2.00
<b>Emerging</b>				Maturity (10yr-1yr)	1.43	1.98	2.82
Brazil	2.82	3.14	6.16	Implied Inflation	1.78	2.07	2.00
China	2.83	3.18	4.08				
India	8.36	8.40	8.46				
Russia	8.87	8.09	4.73				

**Commodity, Real Estate, & Currency Returns  
For Periods Ending June 30, 2012**

	<u>Qtr</u>	<u>Ytd</u>	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>
<b><u>Commodity</u></b>					
DJ UBS Commodity	-4.6	-3.7	-14.3	3.5	-3.7
CRB Commodity Spot	-4.3	-1.2	-13.6	9.7	2.8
CRB Fat & Oils	-1.3	-0.7	-14.9	15.8	6
CRB Foodstuffs	-0.3	0.9	-9.3	13.1	6.6
CRB Livestock	3.3	6.8	-5.4	19.5	6.2
CRB Metals	-11	-1.7	-20.9	10.4	-1.4
CRB Raw Industrials	-7	-2.6	-16.4	7.4	0.3
CRB Textiles & Fibers	-7.7	-7.6	-19.5	1.5	0.9
<b><u>Agriculture</u></b>					
Coffee	-15.9	-30.2	-38.9	5.5	7.4
Corn	-1.6	6.7	-2	15.9	12.2
Soybean	5.4	19.1	3.8	6.3	12.8
Sugar	-13.7	-21	-17.7	8.7	6.3
Wheat	-11.4	-11.4	-13.9	3.7	4.8
<b><u>Energy</u></b>					
Oil	-22.4	-16.4	-14.4	5.8	4.1
Unleaded Gas	-13	3.9	-5.7	8.8	2.7
<b><u>Metals</u></b>					
Aluminum	-13.7	-6.9	-26.3	5.9	-6.8
Copper	-12.3	-1.7	-18.1	14	-0.2
Gold	-4.6	-3.4	4.5	19.1	19.5
Nickel	-11	-9	-25.9	3.5	-16.8
Zinc	-8.8	-2.9	-16.9	6.1	-12.5
<b><u>Real Estate</u></b>					
MSCI U.S. Reit	3.8	14.9	13.2	33.1	2.6
MSCI World Reit	2.3	15.1	2.2	17.4	-3.6
<b><u>Currency</u></b>					
	<b><u>U.S. Dollar Returns</u></b>				
Euro	5.1	4.6	12.9	3.6	1.3
Japan	-3.8	2	-1.4	-6.4	-8.4
U.K.	1.6	0.2	4.1	1.7	4.8
Brazil	14.1	11.4	29.2	1.5	1.2
China	0.8	0.2	-1.7	-2.3	-3.6
India	11.1	6.8	24.8	5.5	6.6
Mexico	9.2	1	17.9	1.4	5.1

## Current Economic & Financial Conditions

	Percent Change					Data As Of
	3 Month		6 Month		1 Year	
	3 Month	Annualized	6 Month	Annualized		
Gross Domestic Product	0.5	1.9	1.2	2.4	2.0	March/2012
Leading Economic Indicators	0.5	2.1	1.9	3.9	1.7	May/2012
ECRI Weekly Leading Index	-3.7	-14.0	1.5	3.0	-4.0	June/2012
Commercial and Industrial Loans At All Commercial Banks	3.6	15.0	7.5	15.5	13.9	June/2012
Retail Sales	-0.2	-0.7	1.4	2.9	5.0	May/2012
Retail Sales (Excluding Food Service)	-1.3	-5.1	0.6	1.2	3.5	June/2012
Real Disposable Personal Income	0.7	2.6	0.9	1.9	1.1	May/2012
Industrial Production	1.0	4.0	1.6	3.1	4.7	June/2012
ISM Manufacturing: Purchasing Managers Index	-6.9	-25.0	-6.4	-12.4	-10.9	June/2012
4-Week Moving Average of Initial Claims	6.4	28.2	2.5	5.0	-8.7	June/2012
Hires: Total Private	-1.6	-6.2	1.9	3.9	3.6	May/2012
Job Openings: Total Private	2.7	11.1	11.0	23.2	17.1	May/2012
Consumer Price Index	-0.2	-0.8	0.7	1.4	1.7	June/2012
Consumer Price Index Less Food and Energy	0.6	2.6	1.2	2.4	2.2	June/2012
New One-Family Houses Sold	0.8	3.3	12.8	27.3	19.8	May/2012
Median Sales Price of Homes Sold	5.0	21.6	3.9	7.9	2.3	March/2012
S&P 500 Earnings	-0.9	-3.6	-1.0	-1.9	6.0	March/2012
CRB Commodity Spot Index	-4.3	-16.1	-1.2	-2.4	-13.6	June/2012
Spot Oil Price (West Texas Intermediate)	-22.4	-63.7	-16.4	-30.1	-14.4	June/2012
Gold Price	-3.8	-14.5	N/A	N/A	6.2	June/2012

	Actual Value / Diffusion Index				Data As Of
	Current	3 Months	6 Months	1 Year	
	Value	Ago	Ago	Ago	
Phili Fed: General Activity - vs. Prior Month (Diffusion)	-16.6	12.5	6.8	-4.1	June/2012
Phili Fed: General Activity - 6 Months Ahead (Diffusion)	19.5	32.9	40.0	3.7	June/2012
Chicago Fed: National Activity Index	-0.5	0.2	-0.3	-0.3	May/2012
St. Louis Financial Stress Index	0.3	0.1	0.7	0.1	June/2012
Loan Officer Net % Tighter Criteria Consumer Loans	-11.6	-11.6	-7.9	-20.5	June/2012
Loan Officer Net % Willingness to Make Consumer Loans	23.6	11.5	18.8	28.8	June/2012
Consumer Sentiment	79.3	75.3	64.1	74.3	May/2012
Manpower Employment Outlook (Net % Hiring)	9.0	7.0	8.0	9.0	May/2012
Unemployment Rate	8.7	8.6	9.0	9.7	June/2012
University Of Michigan Inflation Expectations	3.1	3.9	3.1	3.8	June/2012
S&P 500 PE	16.1	14.3	13.7	16.3	March/2012
S&P 500 Earnings Yield	6.2	7.0	7.3	6.1	March/2012
S&P 500 Earnings Yield Less 10 Year Yield	4.1	5.0	5.3	2.7	March/2012
AAII Survey: Stock Allocation	58.8	60.7	56.1	59.5	June/2012
AAII Bull/Bear Investor Sentiment Spread	-15.7	17.0	9.8	8.1	June/2012
AAII Percent Bullish 8-Week Average	28.8	44.4	38.2	30.3	June/2012
CBOE Volatility Index	17.1	15.5	23.4	16.5	June/2012
3 Month Treasury	0.1	0.1	N/A	N/A	June/2012
1 Year Treasury	0.2	0.2	0.1	0.2	June/2012
5 Year Treasury	0.7	1.0	0.9	1.6	June/2012
10 Year Treasury	1.6	2.2	2.0	3.0	June/2012
30 Year Treasury	2.7	3.3	3.0	4.2	June/2012
5 Year TIP	-1.1	-1.0	-0.8	-0.4	June/2012
10 year TIP	-0.5	-0.1	N/A	0.8	June/2012
30 Year TIP	0.5	0.9	0.8	1.8	June/2012
Bond Buyer 20-Bond Municipal Bond Index	3.9	3.9	4.0	4.5	June/2012
ML BBB	4.0	4.1	4.6	4.5	June/2012
ML High Yield	7.4	7.3	8.3	7.4	June/2012
ML AAA-A Emerging Market	3.0	3.3	3.6	3.6	June/2012

A diffusion index is the difference between the percent of respondents expecting an increase less those expecting a decrease.



## On the Lighter Side

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Evensky and Katz is a well-known financial planning firm out of Florida. Their recent newsletter came to me while I was writing our quarterly update. Since the continuous tone of economic news has been downbeat for some time, I found some of their postings funny / interesting and thought I would share them. I hope you enjoy them.

### **WHY TEACHERS DRINK**

A few examples of student responses:

- Q. "Name one of the early Romans' greatest achievements." A. "Learning to speak Latin."
- Q. "What did Mahatma Gandhi and Genghis Kahn have in common?" A. "Unusual names."
- Q. "Name the wife of Orpheus, whom he attempted to save from the underworld." A. "Mrs. Orpheus."
- Q. "Where was the American Declaration of Independence signed?" A. "At the bottom."
- Q. "What is a fibula?" A. "A little lie."
- Q. "Steve is driving his car. He is traveling at 60 feet/second and the speed limit is 40 mph. Is Steve speeding?" A. "He could find out by checking his speedometer."
- Q. "What is a vibration?" A. "There are good vibrations and bad vibrations. Good vibrations were discovered in the 1960's."
- Q. "Where was Hadrian's Wall built?" A. "Around Hadrian's garden."

### **HOW TIMES DO CHANGE**

The year is 1911. One hundred years ago:

- The average life expectancy for men was 47 years.
- Fuel for the car was sold in drug stores only.
- Only 14 percent of the homes had a bathtub.
- Only 8 percent of the homes had a telephone.
- There were only 8,000 cars and only 144 miles of paved roads.
- The tallest structure in the world was the Eiffel Tower!
- The average US worker made between \$200 and \$400 per year.
- More than 95 percent of all births took place at home.
- Ninety percent of all doctors had no college education.
- Most women only washed their hair once a month, and used Borax or egg yolks for shampoo.
- The population of Las Vegas, Nevada, was only 30.
- Crossword puzzles, canned beer, and iced tea hadn't been invented yet.
- Two out of every 10 adults couldn't read or write and only 6 percent of all Americans had graduated from high school.

## Jay Leno

If you've ever watched Jay Leno you probably know one of his most popular shticks is his reading of the headlines. Here are some real winners.

Worker suffers leg pain  
after crane drops 800-  
pound ball on his head

**Bridges help people cross rivers**

**City unsure why  
the sewer smells**

**Study Shows Frequent Sex  
Enhances Pregnancy Chances**

**Man Accused of Killing  
Lawyer Receives a New Attorney**

**Homicide victims rarely talk to police**

**Barbershop singers bring joy to school for deaf**

**Man with 8 DUIs blames drinking problem**

**County to pay \$250,000  
to advertise lack of funds**

**Army vehicle  
disappears**

**Caskets found as workers demolish mausoleum**

**Federal Agents  
Raid Gun Shop,  
Find Weapons**

**S**tatistics show that  
teen pregnancy  
drops off significantly  
after age 25.

**Rally against apathy draws small crowd**

**Hospitals resort  
to hiring doctors**

## THE 401-KEG

Hot Investment during this financial turmoil:

If you had purchased \$1,000 of shares one year ago in:

1. Delta Airlines, you will have \$49.00 today
2. AIG, you will have \$33.00 today
3. Lehman Brothers, you will have \$0.00 today

But if you had purchased \$1,000 worth of beer one year ago, drank all the beer, then turned in the aluminum cans for recycling refund, you will have received \$214.00.

Based on the above, the best current investment plan is to drink heavily & recycle. It is called the 401-Keg.

### **Repartees**

- NYC Mayor Ed Koch after the reporter insisted on pressing a point about an inconsistent statement Koch had made – “I can explain it to you; I can’t comprehend it for you.”
- Abraham Lincoln vs. Stephen Douglas, after Douglas called him “two-faced” during a debate – “I leave it to my audience. If I had another face, do you think I would wear this one?”
- Pierre Trudeau vs. Richard Nixon, upon hearing that Nixon had called him an a—hole – “I’ve been called worse things by better men.”
- Oscar Wilde vs. Lewis Morris... Morris had just been passed over for the Poet Laureateship – Morris “There’s a conspiracy against me, a conspiracy of silence but what can one do? What should I do?” Wilde: “Join it.”
- Mohandas Gandhi responding to a reporter – “What do you think about Western Civilization?” Gandhi: “I’m all for it.”
- Bill Clinton vs. Dan Quayle, after Quayle revealed that he planned to be “a pit bull” in the 1992 campaign – “That’s got every fire hydrant in America worried.”
- Henry Clay vs. Massachusetts Senator Daniel Webster after seeing a pack of mules walk by – Webster: “Clay, there goes a number of your constituents.” Clay: “Yes. They must be on their way to Massachusetts to teach school.”
- Winston Churchill vs. a Member of Parliament – MP: Mr. Churchill, must you fall asleep while I’m speaking?” Churchill: “No, it’s purely voluntary.”
- Reverend Edward Everett Hale when asked if he prayed for the Senators – “No. I look at the Senators and pray for the country.”

### **I’ll bet you didn’t know**

- Coca-Cola was originally green.
- The percentage of Africa that is wilderness: 28%. The percentage of North America that is wilderness: 38%
- The average number of people airborne over the U.S. in any given hour: 61,000
- $111,111,111 \times 111,111,111 = 12,345,678,987, 654,321$
- Q. If you were to spell out numbers, how far would you have to go until you would find the letter 'A'? A. One thousand
- Q. What do bulletproof vests, fire escapes, windshield wipers and laser printers have in common? A. All were invented by women.
- Q. What is the only food that doesn't spoil? A. Honey
- Q. Which day are there more collect calls than any other day of the year? A. Father's Day