

SOMETHING'S GOT TO GIVE

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Creating titles is often more fun than writing the commentary. This month, several were considered: "Hot In the Kitchen", "School Recess", "The Outhouse Sure Stinks", or "Austerity is Tough Business". "Something's Got to Give" seemed to best capture many of the above and also seems to best represent recent client questions and comments. Investors are worrying about surging oil, food and commodity prices and other headwinds. These seem likely to slow global growth. Additional economic drags include: Japan, fiscal constraint (US and foreign), end of QE2, central bank tightening, Eurozone peripheral countries, and US home prices. There is fiscal tightening all around the world, including the US (fiscal policy) and emerging market central banks. As global growth slows some, it should put downward pressure on oil and commodity prices (their high prices sow the seeds for their own reversal). It appears something's got to give.

Generally, April market performance was the second best of the year thus far for client portfolios. Despite all the worrisome issues listed above, corporate earnings are growing which is boosting stock prices. With low interest rates on money market funds and bonds, some daring investors are pursuing risk via stocks and stock-like bonds. Client bond portfolios, focused on corporates continue to perform well; stocks provided the bigger boost in April with foreign doing better than domestic (large domestic stocks with foreign sales also did well).

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Style	April	YTD
Foreign	+5.6%	+8.9%
Small Growth	+3.9%	+13.6%
Mid Growth	+3.3%	+11.8%
<i>S&P 500</i>	<i>+3.0%</i>	<i>+9.0%</i>
Large Growth	+2.8%	+8.2%
Large Value	+2.6%	+8.7%
Mid Value	+2.2%	+9.4%
Small Value	+1.6%	+8.6%

Client Objectives (Stocks/Bonds)	April	YTD
20/80	+1.3%	+3.3%
35/65	+1.6%	+4.1%
50/50	+2.1%	+5.4%
65/35	+2.6%	+6.3%
80/20	+2.6%	+6.3%
95/5	+2.9%	+7.2%
<i>S&P 500</i>	<i>+3.0%</i>	<i>+9.0%</i>

Growth-oriented client portfolios lag the S&P 500 year-to-date due to a slow start in January and early-February from exposure to foreign stocks which underperformed domestic during that time period. April provided some narrowing of the gap as foreign beat domestic. Market leadership can change from month to month.

We continue to expect stocks will provide better returns than bonds in 2011. It is also appropriate to own a more global focused portfolio than in the past. We are investing with care, watching world events, the troublesome direction of oil prices, and US debt/deficit issues. The "can is still being kicked," but we also feel the "bill is coming due." Selling austerity is one of the tough jobs in politics. The process will not be pretty, but the US debt ceiling will likely be lifted with modest reforms.

We expect the Federal Reserve will remain accommodative after QE2 ends in June. The Fed views inflation as being within its comfort zone (there's a difference between commodity price inflation and long-term inflation expectations). If the Fed were to error in its policy direction, it is much more likely to err on being too easy rather than too tight. In an opposite fashion, Republicans and the Democrats/President will keep it "hot in the kitchen" (or "the outhouse stinks") while they banter over best actions to reduce deficits/debt. Polls show voters are concerned about near-term spending, not entitlement spending. With stubborn high unemployment and high oil prices, the worry is who will keep the economy growing: the private sector when it appears unable, or the public sector which cannot afford to do it and/or does it poorly. In just about every poll, by a

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SOMETHING'S GOT TO GIVE -CONTINUED-

roughly 2 to 1 margin, the public opposes cutting entitlements and tax increases (that's the perspective of one party versus the other). The US problem is however a spending issue, not a revenue problem. Historically, tax revenues from all sources represented 18% of US GDP. At present Social Security, Medicare, plus Medicaid represent 18.4% of GDP; that's before defense, interest expense and discretionary spending are included. At present, all spending represents almost 26% of GDP (a level not broached since WWII). Over the coming weeks/months, expect the Federal Reserve to error on accommodative policy, while Congress creates too many headline worries. The Fed will be the adult supervisor to a Congress and President that will often resemble elementary school recess.

So how should one invest (how are we investing) when everyone knows something's got to give? A part answer relates to how you see yourself – as an optimist or a pessimist. It's where your actions, not words, show up. Were you more optimistic when you were less well informed? Optimists don't hedge; they invest. Diversification is important to our investment process and success. It incorporates "buckets of time" assets into portfolios. It utilizes actively managed no-load mutual funds with historically attractive performance. And, most critical is the knowledge that portfolio investment success has little to do with the number of information inputs we receive/monitor and more to do with the length of time we are willing to hold them. Clients have different time horizons affecting their objective. That's why we own various "buckets of time" assets in portfolios to provide flexibility. "Something has to give", but it shouldn't be your investment objective or investment time horizon.

We hope these comments are helpful; drop us a note or give us a call.



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