

THE "NEW NORMAL" FUTURE

Bill Henderly, CFA, Nvest Wealth Strategies, Inc.

Over the past few months, global equity markets have rallied strongly as the depression scenario has been "priced out" of the market. Many investors are surprised by the strength of performance in stocks, corporate bonds, and commodities. In the start of the recovery, leading indicators are rebounding in sync across the world. This has significant implications for US markets.

Foreign stock funds, led by emerging markets, eclipsed US stock funds by a wide margin in May. Foreign surged +13.8% compared to US equities gaining +4.8%, and the year-to-date difference is likewise wide. Most bond categories provided attractive returns, except Treasury securities fell (huge new supply to finance deficits and stimulus). Despite recessionary headwinds and rising unemployment, we have possibly seen the lows in both the economic indicators and the market indices. The stock market recovery will precede an inevitable earnings turnaround.

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Style	May	3 Mos	YTD	Client Objectives			
				(Stocks/Bonds)	May	3 Mos	YTD
Foreign	+13.8%	+38.7%	+15.7%	20/80	+2.6%	+7.2%	+5.1%
Large Value	+6.4%	+27.1%	+1.4%	35/65	+2.9%	+9.6%	+5.5%
S&P 500	+5.5%	+25.6%	+2.8%	50/50	+3.5%	+12.2%	+5.6%
Large Growth	+4.8%	+24.4%	+10.5%	65/35	+4.1%	+14.5%	+5.9%
Mid Value	+4.5%	+30.2%	+7.5%	80/20	+4.3%	+16.0%	+6.5%
Mid Growth	+4.4%	+27.5%	+12.7%	95/5	+5.4%	+21.6%	+8.4%
Small Value	+4.2%	+33.6%	+4.1%	S&P 500	+5.5%	+25.6%	+2.8%
Small Growth	+3.9%	+27.4%	+8.2%				

Client portfolios still hold too much cash. We welcome the "Spring Rally" (started March 9), but feel self-imposed pressure to re-invest cash held during the bear market corrections (it really helped during the market meltdown). Despite large money market cash balances, a glance at client objective returns indicates attractive recovery performances. Looking at broad asset class returns (stocks or bonds), we see very attractive index beating performances signifying use of strong active-managed mutual funds in client portfolios. Our biggest risk is getting cash reinvested. Our challenge is: will the market pull-back some (we expect) or continue to run? We expect an interest rate hic-up will temporarily stall the "Spring Rally" and that various headwinds will make the continued rally a slower process.

During 2007 and 2008, the US and world economies hit a "dead-end". They were unable to continue on their prior path due to debt exhaustion and poor capitalization choices. And, they are not capable of embarking forward on a new path due to ongoing deleveraging (result: considerable collateral damage). The economy late last year had a "sudden stop" or cardiac arrest. In essence, there is no turning back to prior days. The future will develop a "new normal" for our financial health.

CONTACT US:

2310 Home Road
Delaware, Ohio 43015
740.917.9234

WWW.NVESTWEALTH.COM
Email: info@nvestwealth.com

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THE “NEW NORMAL” FUTURE -CONTINUED-

It is difficult to describe a “new normal” as it will evolve over the next several years. It will entail, as Bill Gross of PIMCO calls it, “DDR” = de-leveraging, de-globalization, and re-regulation. US and developed world economic growth will likely be subdued, running at a slower “speed limit” due to de-leveraging. Developing or emerging markets will likely see more rapid growth from within plus receive stable slow demand from the developed economies. Unemployment may remain high. The heavy hand of government will be evident via much greater regulation and new taxes; “banking” may be a shadow of its prior. Availability of credit will be limited except for the best of borrowers (who don’t need it). And, risk may tilt over time toward higher sovereign focus (in other words, the US needs to correct its leveraged balance sheet to retain financial influence).

Investing forward, from our perspective, involves greater exposure to foreign stock funds to capture alpha over domestic. It likely includes use of commodity and US TIPS funds; and at some future point a return focus on short high quality bond investments. At this juncture, the early recovery favors diversification among styles and different capital-size stock funds with exposure to corporate bonds. We expect opportunistic investing in different styles and strategies will make investing in the “new normal” a different challenge for inexperienced investors. Investing in the “new normal” may be much different than our past experiences.

We welcome your comments and thoughts. In these difficult transitioning times, let’s meet to review your portfolio. And please pass our name on to your friends who likely also need our help and experience.

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www.nvestwealth.com

2310 Home Road

Delaware, Ohio 43015

Ph: 740.917.9234

Fax: 740.917.9234

Email: info@nvestwealth.com