

RENT, NOT OWN

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Many believe that perception is (at least) 90% of reality. In other words, perception is more influential than reality; what we perceive to be true influences us more than what is true.

Investors often get caught in a perception versus reality attitude. Recent market events can suggest a future bad (or good) experience. And then, when a large number of market players act on perception, reality is disguised or hidden. Perception sometimes even appears to become reality.

Following emotional market declines in May and June (correction following 15 months of a new bull market), perception could easily predict trouble for July. After all, volatility and technical chart watching suggest the market is driven by short-term professional day traders – buying and selling baskets (ETFs and synthetic securities) of investments not based upon fundamentals. They, technical traders, uniformly and somewhat predictably pile on to the sell side (or buy side) when particular price levels are hit (trade “baskets” in the morning and unwind in the afternoon). They are accustomed to looking at the market as “risk on/risk off” trades. The result was individual securities packaged in baskets traded more alike (meaning they move up/down together, instead of separately based upon individual fundamentals); creating market volatility because of short-term day trading. This activity/volatility creates the perception by long-term investors (evaluating fundamentals of individual investments) to wonder if investing is worth it. In essence, is the current market perception a new reality? Is recent action a rent, not own market?

July did not provide continued trouble for investors (it did create some trouble for short-term day traders). The S&P 500 rebounded 7% during the month, and was one of its best performances in the past year. The index is still negative for the year-to-date, but close to breakeven. Most all asset groups and styles performed well. Client portfolios rebounded nicely, and should provide encouragement as all portfolio objectives show positive performance for YTD.

Style	July	YTD
Foreign	+9.6%	-3.3%
S&P 500	+7.0%	-0.2%
Large Value	+6.9%	-0.8%
Small Value	+6.8%	+5.6%
Mid Value	+6.8%	+3.7%
Mid Growth	+6.7%	+3.2%
Large Growth	+6.7%	-2.6%
Small Growth	+5.6%	+2.9%

Client Objectives (Stocks/Bonds)	July	YTD
20/80	+2.2%	+3.2%
35/65	+3.2%	+3.1%
50/50	+4.1%	+2.8%
65/35	+5.1%	+2.6%
80/20	+5.2%	+1.8%
95/5	+5.8%	+1.1%
S&P 500	+7.0%	-0.2%

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Perception about the road ahead reflects confusion. Investors are perplexed. And, doubt always aims for the investor’s feelings as a prime target for attack. The result: perception and feelings of fear lead to confusion, leading to indecision, frustration, passivity, and lack of progress. FEELINGS – are a major challenge to long-term investing and success.

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RENT, NOT OWN -CONTINUED-

Investors, and even members of the Fed, are divided about the future – holding an outlook for a double-dip vs. cyclical recovery, and inflation vs. deflation. Our base case (research based) expects the current cyclical recovery to continue, albeit sluggishly. We do not expect a double-dip, which is caused typically by policy mistakes (in 1981 by raising interest rates), while short cycles seem likely (like those of the 1950's). Absent a major policy mistake or market vigilantes attacking the level of US deficits with huge tax increases (or VAT), the current cycle does not appear setup to follow the double-dip profile. Economic recovery is easier than economic expansion – sluggish, positive growth of 2% and providing some help with unemployment. This is because deleveraging debt by individuals and governments (implementing new regulations and taxes) will promote sluggish, positive growth.

Policies to “cushion the blow” of US real estate debt bubbles have worked. However, because we still are lacking the credit mechanisms, as debt service burdens remain elevated by governments and individuals (debt created longer business cycles in past decades), this business cycle is likely to be shorter than recent past.

We expect the financial markets, stocks in particular, to work higher but with confusion (meaning volatility will be present). At the moment, perception of volatility (risk) is upside down. Bonds, with very low yield (money market funds with no yields) are where investors are investing cash. Some investors didn't like 10-year Treasury Note yields of 4% in April, but like them now at 2.9%. But why buy a 10-year corporate bond at a 2.5% yield when the same company's stock offers a 4% dividend yield? Risk is upside down. Perception is stocks, after 2 bear markets in the last 10 years generating negative returns, are risky investments. They are also inappropriately priced. Some investors say “bonds are safe” (perceived low risk, despite low yields equating to high prices).

Nvest Wealth Strategies is looking beyond perception; focusing on the reality of asset values. Stocks are cheap (many with dividend yields higher than bond yields), while bonds are expensive (low yields). During the short-term, investors will use perception focused on the prospects of bad outcomes – 1) extremes for inflation or deflation; 2) uncertainty created by global macro tensions and the political environment; and 3) too much cash in corporate balance sheets - as reasons to expect poor stock returns. Long-term investors view the current market environment as an opportunity to own (not rent) quality global investments. Funny; it's often much easier to see quality investment ideas offering attractive value when the perception of the market is worried. During times of worry, perception concludes all risk investments are unattractive, when in reality they are just the opposite.

Nvest Wealth Strategies manages client portfolios for the long term opportunities available via different asset classes. Our disciplined process has provided investment success to our clients.

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