Investor Insights & Outlook

April 2011 Vol. No. 4 Investment Updates

Filomeno Wealth Management, LLC Newsletter

Filomeno Wealth Management News

Enclosed is your 2011 1st Quarter Portfolio Performance Review Report for your Schwab account(s). This report has a new format and presentation "look". Our goal is to make it easier to read and a more valuable resource to you. The fund information included in the old report format has been eliminated because it is repetitive information which is included on your monthly Schwab statement(s). As in the past, this report includes asset allocation, components of change and portfolio returns.
Please do not hesitate to contact us if you have any comments or questions.

FORM ADV Part 2

The Securities and Exchange Commission has adopted amendments to filing of the Form ADV Part 2. First, ADV Part 2 follows a new format that represents a shift from "check-the-box" disclosure to a narrative, plain English style of information delivery organized in a uniform, consistent manner. Second, brochure supplements are now required to provide information about the firm employees providing advisory services to clients. Finally, Form ADV Part 2 is publicly available at WWW.ADVISERINFO.SEC.GOV and advisers are subject to an annual update obligation to provide a summary of any material changes.

These amendments are considered to be some of the most important investor protections in decades. If you would like us to e-mail or send a hardcopy of Filomeno Wealth Management's new ADV Part 2 to you, please let us know.

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Filomeno Wealth Management, LLC
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Advisor Corner

Enclosed is your Schwab Portfolio Performance Review Report as of March 31, 2011.

Monthly Market Commentary

The market has had its ups and downs in March, but the overall atmosphere has been optimistic in light of less negative news from Japan and the Middle East. On the not-so-optimistic side, however, bad news on the European debt crisis (Portugal in particular) may signal some dark clouds looming ahead.

Employment: After a year of almost no progress, employment statistics have finally begun to show some improvement. Current unemployment claims are in the 300,000–350,000 range, approximately half of the 674,000 we've seen in the early months of 2009. Since 20%–25% of the jobs lost during the recession were in the construction sector, significant improvement in unemployment numbers may not occur until both the homebuilding and construction industries recover. Still, in light of these recent positive numbers, next week's jobs report is an eagerly awaited piece of news.

Consumer spending: Other statistics to be released next week include personal income and spending data for the first quarter of 2011, which may provide insight into whether consumer confidence is back or still waning. Consumption numbers are crucial data points for quarterly GDP forecasts, which for now appear to be in the 2.0%–4.0% range. With higher inflation rates and volatile import numbers, Morningstar analysts estimate that first-quarter GDP growth may be on the lower side of this range. However, companies will start reporting corporate earnings next month, significantly impacting the market and economic forecasts.

Tech sector: Excellent news from the tech sector fueled the market in recent weeks, with some technology companies reporting revenue growth as high as 25% and raising their dividends. In the improving economic environment, businesses now have more money to invest in new technologies, such as cloud computing, which in turn may fuel future growth.

Housing market: Unfortunately, housing data still does not indicate any significant improvement. New and existing home sales in February were dismal; only 250,000 units were sold, a new record low dating back to the 1960s. This is in sharp contradiction with realtors' and builders' optimism about the spring selling season. Even when taking seasonal factors into account, such as bad weather and low temperatures, the outlook remains bleak.

Economic growth: The GDP number for the fourth quarter of 2010 has been revised for a third and final time, from 3.3% to 2.8% and now back to 3.1%. Increasing consumer confidence was reflected in strong spending on consumer durables, with modest growth in non-durable goods and consumer services displaying the smallest growth. The overall message is clear: consumers are back, increasingly confident and willing to spend.

The tale of two recoveries (rich versus not so rich): As worrisome as this news may be, it is by now clear that so far in the recovery higher earners have fared much better than their counterparts (especially those with less education). The latter continue to face double-digit unemployment and have difficulties confronting the higher food and energy costs. Further pain in the lower income brackets may create a ripple effect and stall overall economic growth.

Quarter-end insights: Although this year started on a bad note, Morningstar economists are optimistic and predict that real GDP growth of 3.5%–4.0% may still be possible if inflation doesn't get out of control. However, this is a big "if." Judging by the already-rising fuel and food prices, inflation may reach 3% in no time (the annualized increase in the Consumer Price Index over the last six months is an even more frightening 3.9%). Looking forward, consumer spending remains key, as well as business investing. These may well be the two most important determinants of the recovery for the rest of the year.

The Asset Allocation Puzzle

Possessing a considerable amount of knowledge about stocks, bonds, and cash is only a small part of the investment planning process. Many investors are under the false notion that the greatest determinant of portfolio performance is the specific investment choices that they make. In reality, the biggest decision you will make is how much to allocate to different investment categories. Asset allocation is all about finding the mix of investments that is right for your situation. Goals, time horizon, and risk tolerance are some of the key factors that should be taken into consideration when allocating assets.

Goals: Determining what asset allocation is appropriate depends largely on the goals you seek to achieve. Are you saving for retirement, college education for your children, or a vacation home? Each goal must be considered in creating the appropriate asset mix.

Time Horizon: Time horizon is the length of time your portfolio will remain invested before withdrawals need to be taken. If your average investment horizon is fairly short, you will most likely want a more conservative portfolio—a portfolio with returns that do not fluctuate too much. If your investment time horizon is longer, you can most likely invest more aggressively.

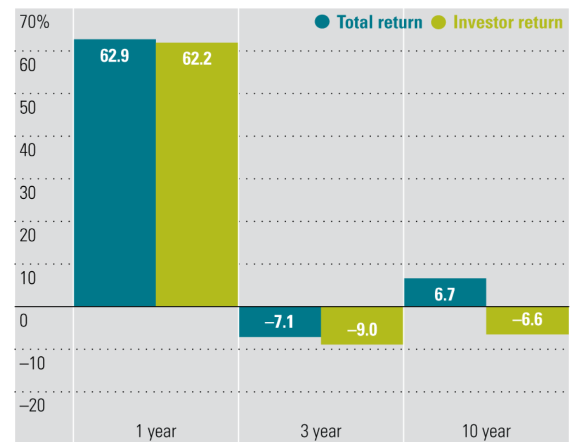
Risk Tolerance: Everyone has a different emotional reaction to sudden changes in their portfolio value. Some people have trouble sleeping at night because they are too busy worrying about how their portfolio is performing. Other investors are unfazed by fluctuations in the market and can endure the uncertainty associated with more risky investments.

Chasing Performance

Investors often endure poor timing and planning as many chase past performance. They buy into funds that are performing well and initiate a selling spree following a decline. This becomes evident when evaluating a fund's total return compared with the investor return. Overall, the investor return translates to the average investor's experience as measured by the timing decisions of all investors in the fund.

The image illustrates the investor return relative to the total return for a given fund. Over the short term, both the total and investor returns were positive, with the investor return ending slightly lower. Over a 10-year period, however, total return greatly exceeded investor return. Investors who attempted to time the market ran the risk of missing periods of exceptional returns.

Comparison of a Fund's Return Performance Over Time



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. Returns and principal invested in stocks are not guaranteed. Morningstar investor returns measure how the typical investor in that fund fared over time, incorporating the impact of cash inflows and outflows from purchases and sales. It is not one specific investor's experience, but rather a measure of the return earned collectively by all the investors in the fund. Total return measures the percentage change in price for a fund, assuming the investor buys and holds the fund over the time period, reinvests distributions, and does not make any additional purchases or sales. Investor returns are not a substitute for total returns but can be used in combination with them. Data as of February 2010.

Source: The fund illustrated in this example was selected from Morningstar's open-end database.

The Many Faces of Inflation

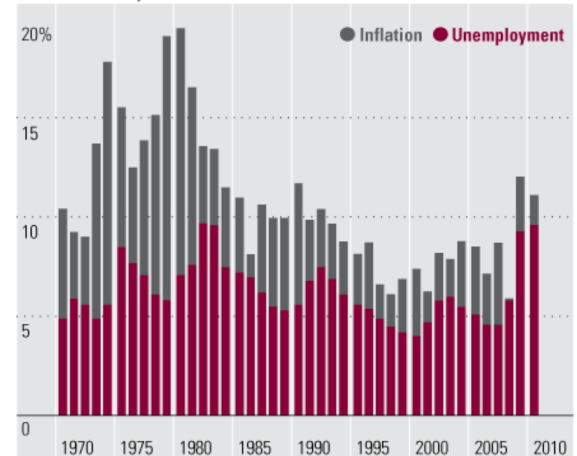
During the recent 2007–2009 recession, it seems all we've seen and heard about the economy was bad news: the housing market collapsing, 401(k)s suddenly being worth much less than before, a lifetime of savings almost disappearing in a few months, rising unemployment, and fluctuating prices. Now that the recession has officially ended in June 2009 and we're on the road to recovery, inflation may become a concern once again. In this uncertain economic climate, it may be helpful to learn about the different types of inflation and their immediate effects.

Inflation: Inflation is defined as a continuing rise in the general prices of goods and services. Simply put, if prices, on average, are going up in an economy, then you've got inflation. With a set amount of money in an inflationary environment, consumers are able to buy less and less over time. High rates of inflation can generate uncertainty, lower productivity and discourage investment. The leading measure of inflation in the United States is the Consumer Price Index (CPI). The government can change its monetary policy to control the money supply and keep inflation in check, although this is not the only variable affecting inflation. In November 2010, the Federal Reserve announced it would buy back long-term Treasuries in order to inject money into the economy, a policy called quantitative easing, which can trigger higher inflation.

Hyperinflation: Hyperinflation is extremely high, out of control inflation, caused by a steep increase in the money supply without a corresponding increase in the output of goods and services. Well-known examples include the German hyperinflation after World War I and the hyperinflation in Hungary after World War II. It appears that such an extreme phenomenon occurs mainly as a result of radical changes and prolonged economic instability.

Deflation: Deflation is the opposite case: a general decline in the prices of goods and services. In the U.S., deflation occurred as recently as 2008 and 2009: The change in CPI was negative in the third and fourth quarters of 2008 and in the fourth quarter of 2009, a clear indicator of deflation. The obvious positive effect here is lower prices—many argue that deflationary periods are good times to buy. The problem with deflation, though, is that consumers reduce spending and businesses stop growing, which is not good for the economy.

Stagflation: This is the worst-case scenario: high inflation and slow growth simultaneously. Normally, there is an inverse relationship between inflation and unemployment; if the economy is able to tolerate a higher rate of inflation, lower unemployment can be achieved, and vice versa. But during a stagflation period, both inflation and unemployment go up. An interesting measure for stagflation is the misery index, which, as illustrated in the image, combines the unemployment and inflation rates. The U.S. experienced severe stagflation in the 1970s, when unemployment and inflation reached a combined high of almost 20%. There has been talk of stagflation during the recent crisis as well, but the potentially encouraging news is that the misery index is not nearly as high now as it has been in the past.



Source: Inflation is represented by the Consumer Price Index, and unemployment by the national unemployment rate, not seasonally adjusted, from the Bureau of Labor Statistics.

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Fund Review

In this issue we review the Vanguard Inflation-Protected Securities Fund (see attached Morningstar profile) which is a Morningstar Analyst Pick. The strategy of this bond fund is to provide inexpensive exposure to U.S. Treasury Inflation-Protect Securities. The fund invests in bonds that are backed by the full faith and credit of the federal government and whose principal is adjusted quarterly based on inflation. There are 30 bonds in the fund (A) with 100% of the holdings with a credit quality of AAA (B). The 12-month yield for the fund is 2.52% (C) and the expense ratio is low at .25% (D). We use this fund in many of our clients' portfolios as a government bond holding.

Our People and Their Activities

Filomeno Wealth Management recently hosted an evening at the Hartford Stage with a cocktail reception and performance of Snow Falling on Cedars. Many of our clients were able to attend this enjoyable evening.

The Investment Answer is a book written by Daniel C. Goldie, CPA, CFP & Gordon S. Murray. This book explains – in plain and simple English – the five basic choices about investing. We highly recommend that all of our clients read this book as it is an easy read and very informative. If you would like us to send a copy to you, please contact Kim Lockwood at 860-760-7052 or e-mail her at KJL@FILOMENOWEALTH.COM.

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