



ECONOMIC UPDATE

*Individual Solutions
From Independent Advisors*

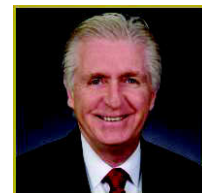
July 2010

We have just completed the second quarter of 2010, with the economy and employment improving only slightly and the investment markets giving back all of the gain (and then some) earned in the first quarter. Through June 30, the S&P 500 is down over 6% and the EAFE, the most common foreign index was down double that at minus 13%. July has shown some improvement, at least through mid-month.

There is a sense of fear that I find surprising given that we are pretty clearly beyond the worst case scenario of 18 months ago. I attribute that to something I learned in my behavioral finance reading, that we are highly sensitive to events or experiences (especially negative ones) that are similar to ones recently experienced. In this case it is the significant decline in stock values we experienced from late 2007 until March 2009. While no one is forgetting those fearful times, some are still reliving them (and occasionally making decisions) every time the market drops or the media trumpets the next financial disaster, almost none of which actually ever occur.

Our concern is that people sometimes confuse volatility with risk. They are as different as the difference between your plane crashing or just experiencing turbulence on a flight. It seems that there is always concern that the temporary drop in price that is a normal part of investing is a harbinger of more bad news in the future. Reacting to volatility can be a very expensive decision, particularly when you realize that the markets have historically recovered in the past.

Although there is plenty to cause concern, I believe there is a lot more to feel good about as I look forward. Admittedly, I have been an optimist ever since I was told at age 10 that if I got under my desk in 5th grade that I could survive a Russian nuclear attack (if that does not make you feel that anything good is at least possible,



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nothing would), but I really see the potential for positive outcomes that I have not seen in many years.

First, almost every important economic statistic is improving, though perhaps not as fast as we would like. Corporate earnings continue to be on a record pace and within a few years, the consensus is that the earnings for the S&P 500 will reach an all time high. Generally, though not always, stock prices follow. The S&P is now trading at approximately 11 times 2011 earnings whereas in normal times, with higher investor confidence, stocks would likely trade at 15 times earnings and often even higher.

Second, there is virtually no inflation in the US, interest rates are at 50 year lows and housing is reasonably priced, though not many people seem to care at the moment. Our economy is growing and other economies are growing as well, with China, India and Brazil leading the way. The consensus for US growth over the next 2 years is over 3% per year, not great, but not terrible either. We are actually ahead of the first year growth coming out of the last 2 recessions in 1990 and in 2001, according to the Wall Street Journal. Our gross domestic product (GDP) will hit an all time high during this quarter. After the Great Depression, it took the US economy 15 years to get back to the pre-depression GDP. This time, a year and a quarter. Not too bad!

China, India and Brazil, with over 3 billion citizens between them, are expected to grow at over 7% per year over at least the next two years. Greece is still a mess and likely to remain so, but with a GDP that approximates the gross sales of Wal-Mart, its economy is smaller than Austria's and a little bigger than Finland's. Greece is unlikely to bring down any place besides Greece and there is a silver lining in their problems that may benefit us. By seeing what can happen when you, as a nation, allow deficits to spiral so far out of control that default and reorganization are your extremely painful options, we get a sneak preview of what could happen to us if we do not get our spending habits in order. I do not believe that the US would ever incur the problems of Greece, but I think it is a possibility unless corrective action is taken. I believe that action will be taken, and has already begun in some areas and nationwide in November. The basis for my confidence is the realization among almost everyone I speak with, regardless of political philosophy, that our public debt is growing far too rapidly and threatens our future as well as those of generations to come.

Some specific announcements continue to show economic progress, at least for some companies. Ford (\$11.81) has announced the building of a \$450 million production facility in Thailand to serve their Asian business. Procter and Gamble (\$61.61) just announced that their sales in India have grown by over 20% for the 8th straight year. On July 13th, Intel (\$21.47), the world's leading chip maker, announced record profits.

The US Department of Labor announced that April job openings increased over 10% to 3.1 million openings, the most since December 2008. The bottom, in July 2008, was 2.3 million openings. The "normal" number is 4.5 million, so we still have a way to go. Also, the National Association of Business Economist just announced survey results that indicate companies anticipate additional

hiring in the third quarter. Lastly, according to the US Treasury Department, foreign investment in US stocks and bonds for March and April (\$223 billion total) was the largest 2 month purchase by foreigners in the 32 years records have been kept. A nice vote of confidence in our future!

As I have done several times in the past, I am enclosing (or attaching if emailed to you) an article by well-known financial author, Nick Murray. I feel this is very timely and relevant and I think you will find it interesting and enjoyable to read. It is titled, "Everybody Doesn't Like the Stock Market...But Nobody Doesn't Like Sara Lee". Very thought provoking, let me know what you think of it.

Although I believe we are slowly but surely on our way to a sustainable recovery, there are some serious storm clouds on the horizon.

First among them is that while historic low interest rates are great for borrowers, they are not so good for savers, retirees or those looking for low volatility investments. Many people simply cannot afford their current lifestyles on 1 and 2% fixed rates of return. To potentially address this income shortfall, Raymond James has introduced a portfolio which is designed to produce higher income and lower volatility. We have also designed for some clients our own portfolio of fixed income investments, and we are pleased with the results so far. In addition, a number of the investment firms are developing strategies designed to address the possibility that this low rate environment continues for a number of years to come.

Second, there is a lack of confidence in many areas of our economic life. We hear it from our clients and numerous national polls support the idea that many of us have lost faith in major industries (finance/banking being #1) and federal and state public officials. The President's ratings are low and falling, Congress's approval rating is an abysmal 15% and there is a significant lack of confidence in the political direction we are heading. While I understand that feeling to a point, I believe that steps that have been taken or will be shortly are long overdue and will, as they evolve over the next 5 to 10 years, put us in a much better position as a country. This is painful for many, especially those either unemployed or underemployed. The cleansing of the excesses of the past 20 years is essential and will ultimately prove beneficial, but it is not pleasant and with that unpleasantness is a palpable lack of confidence at present.

Until the confidence issue is resolved, unemployment will continue at a high rate. Though US businesses are currently holding almost \$2 trillion in cash reserves (at almost no rate of return), they are not investing it in new employees, equipment, technology, facilities, etc. until they are more confident in both the economic and political environment in which they will operate. The sooner we get some pro-business legislation (however that is defined), the sooner you will get more employment. At present, we need the economy growing at 3.9% per year for 5 years to get back to even 6% unemployment, according to JP Morgan. Unless we provide some incentives that will grow the economy, which at present is expected to grow at less than 3.5%, the jobs will not return any time soon. Perhaps the November elections will provide some clarity on government direction.

Third, several recent surveys have indicated that as many as 4 in 5 Americans will not have sufficient savings to retire on time...or at all. According to international consulting firm Hewitt Associates, people need 15.7 times their final pay to cover living expenses, inflation and uninsured medical expenses. Social Security will provide 4.7 times final pay, leaving people's savings to make up the other 11 times. Many people are afraid to invest or are concentrating on paying off personal debt and therefore will have an even more difficult time accumulating assets for retirement. According to a second survey, this one from the Employee Benefit Research Institute, 43% of American workers have less than \$10,000 saved for retirement. It shows you how much our past lack of financial discipline has impacted so many people.

For many of you the following commentary may be one you have heard from me in the past, but I think it is worth repeating. For our new clients and their advisors, this may be a first for you.

As of April, I have been in the financial planning field for 35 years and just turned 60 as I finished this letter (July 14th if you want to send me a card next year). On Friday, July 14th, 1950, the Dow Jones Industrial Average closed at 197.44, with total share volume of 2.6 million. Yesterday, that same market index closed at 10,366.72, with volume of 4.5 billion shares. I was unaware of the market in 1950 but I have witnessed a lot since then. Since beginning my business career, I have seen the end of the Vietnam War, 13% inflation, 20% money market rates and once obtained a 13.85%, 10-year CD for a client. I watched one president's resignation and another's impeachment. Oil wars, oil embargos, and the current massive oil spill, which is truly a disaster from numerous perspectives. We have had several banking crises in the US, the first in the late 1980's, the second one is still with us. There have been a number of foreign financial crises that were supposedly not resolvable, currently Greece. In the past 16 years, we have had a foreign debt/currency crisis in Mexico (1994), Russia (1998), and Thailand (1997, spreading to other Asian economies). I have experienced recessions in 1982, 1990, and 2001, as well as the economic impact of September 11. At the time that each occurred, each was going to bring us financially to our knees, maybe permanently. None did and we are still standing, a little wobbly perhaps, but coming back as only the American economy has done, repeatedly, for over 200 years. That's not my opinion, that's a fact. I do not see a different outcome this time, even though some of the problems are entrenched deeply enough to make a full recovery take longer than normal.

I am very encouraged by our resiliency as a national economy. People are fearful and maybe that is a sign that everyone is taking these problems seriously. We still have some tough times to endure and this year's elections promise to be among the most interesting in many years. I expect a real watershed election with issues (many of which are economic) dominating the debate. I also expect the outcome to be good for the economy and ultimately good for investors as we struggle, successfully, to get our fiscal house in order at various public policy levels.

We continue to monitor the predictions and projections of many of the leading economists and, at least so far, those we have followed closely over the years have not changed their fundamental

belief that we are in a recovery that is slow, but sustainable, with the chance of the much heralded “double dip” recession, a long shot. For the record, we have only had had 2 “double dip” recessions in over 100 years and both featured rising interest rates and restricted government money supply. Those two features, largely believed to have caused the double dips, are exactly the opposite of what the Federal Reserve is doing today. The New York Federal Reserve, the nation’s most powerful, estimates the chance of another recession in the next 12 months at less than 1%.

SOME GOOD NEWS FROM EWS

Steff’s long-awaited wedding occurred on July 10th, and both Jessica and Chris played a role in the ceremony with Chris being an usher and Jessica a bridesmaid. Below is a picture of Steff and her husband Mike at the reception:



Jessica, who graduated with a Bachelor’s Degree in Finance on May 14th, took very little time to pass her Series 7 General Securities exam, passing it on the first try (pass rate is less than 70% of those who take it) on July 6th. Jess, who has been working with us almost full-time since high school, has already made a huge impact on behalf of our clients and we are proud of her recent accomplishments.

On October 12th, we are hosting a dinner event at RiverWinds Restaurant featuring Doug Sandler of Riverfront Investments in Richmond, VA. I have heard Doug speak on a number of occasions, and I think you will find his perspective on a wide range of global financial issues to be informative, understandable and helpful as we continue to navigate our way through the most challenging economy and investment climate in my 35 years in business.

As many of you know, I am a huge Phillies fan and have been for many years. My wife Kathy and I actually have been at both World Series final winning games, and I see in them (I hope) and baseball generally many similarities with the economy and investing.

First, it is both a long season and an untimed game, making patience a virtue and haste or panic an additional risk. In terms of the Phillies, their recent series against a division leader (Cincinnati), was very interesting. In the 4 game series, they won the first 3 in extra innings, two of them on game ending home runs, the other on a game ending single. The last 2 games (each a 1-0 victory) featured exceptional pitching and defense. The heroes in at the first game and last two games all recently came off the disabled list, one of them, Carlos Ruiz, the night he scored the first of his consecutive game winning runs. In the first game, the Phillies were losing by 6 runs until the next to the last inning, ultimately winning in the 11th inning on a home run by another person who had just come off the injury list.

By now you must think the 60th birthday has made me a little goofy, tying baseball to investing and financial planning. To me, there are numerous similarities.

In both, you need to be patient, you need to be diversified (you cannot win with 9 shortstops or 9 pitchers), you cannot panic as the game must be played to its completion (kind of like your investment life) and you never know, from one day or game to the next, who or what is going to make the difference for your team or your portfolio. What you do know is that if you put all of the right pieces in place (managers and players), you will have a team designed to meet your goals. You will not be successful every game or even every year. If you are a pitcher, success half the time will make you rich, as will a hitter successful 3 of 10 at bats. We do hold investment managers to a higher standard than that!

Most of your players, like most of your investments, will not do well all the time nor will they all do well or poorly at the same time. If they all do well together, you become the Phillies or the Yankees or the Red Sox, at least for awhile. If you cannot put all the pieces together, you become the Seattle Mariners or the Pittsburgh Pirates, though even those teams occasionally win a bunch of games, just not enough to be good enough to really succeed.

That is my investing/planning analogy. Pick good players/investments/insurance/etc. Make changes when needed, but not all at once. Never try to win with only one type of player or one type of investment. Have good management. Be patient, don't panic. You can win with home runs occasionally, but win more often with players/investments with different talents, with good defense, which includes good pitching. You cannot win in baseball or in investing by always assuming you can hit a home run late in the game, though it does happen from time to time. There are numerous ways to win, home runs being just one of them.

Enough baseball and enough from me. Please read the Nick Murray article and enjoy the rest of the summer. We will be in touch on several events in the fall, beginning with the RiverWinds event on October 12.

Best Regards,

Paul J. Tully

CERTIFIED FINANCIAL PLANNER™

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The S&P 500 is an unmanaged index of 500 widely held stocks. The MSCI-EAFE is a free-float adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States and Canada. The EAFE consists of the country indices of 21 developed nations. The Dow Jones Industrial Average is an unmanaged index of 30 widely held stocks.

Everybody Doesn't Like "the Stock Market"... But Nobody Doesn't Like Sara Lee

Let's say you own a home. Indeed, like many successful Americans, you may even own a couple of them: a primary residence and a weekend/vacation home. If you were telling someone about this, would you naturally say, "I'm in the real estate market"?

I don't think so. Assuming you're enjoying the use of your homes, and are not actively seeking either to sell them or to buy another, you probably—and quite correctly—don't think of yourself as being "in the market" for real estate at all. If asked, you'd most likely say, "Well, we have the house where we live most of the time, and a vacation place up on the lake," or something like that.

But if you own a portfolio of equity investments—mutual funds, for instance, and/or ETFs, index funds, separately managed accounts, or any collection of vehicles which invest primarily if not exclusively in common stocks—you probably don't naturally think (and say), "I invest in businesses," or "I own parts of companies." You may be much more inclined to regard yourself as *being in "the stock market."*

That may be something you want to look at.

Words matter, because they are the way we describe to ourselves the experience we believe we're having. Thus, two people who own the very same equity investments might be having radically different experiences—and, even more importantly, may react very differently to the varying experiences they think they're having.

Say, for example, that two people own the same investment vehicle, which at all times seeks to replicate the Standard & Poor's 500-Stock Index. One person might describe the experience he is having as owning shares in five hundred of the largest, best-financed, most professionally managed publicly-owned businesses in America and the world. The other might describe it as owning "the stock market."

If I think of myself as a patient, long-term investor in superior businesses (which, in the interest of full disclosure, I actually do), I intuitively believe I'm having a positive experience. I see the world quite clearly in a state of rapid economic development—drawing hundreds of millions of people up from poverty and into the middle class—and I think that many of the better global businesses in my portfolio may continue to benefit from this trend. As their revenues grow, so may their earnings, cash flows, dividends and ultimately their share values.

Not all of the businesses in which I own shares will distinguish themselves, of course. Some will turn out to be mismanaged, and will be merged, acquired, or even go bankrupt. Some

will get swamped by other, better companies. Some will be overtaken by more innovative technologies. This is, to me, part of the process which the economist Joseph Schumpeter called creative destruction. I can't know which of my companies will stumble in this way, which is why I'm so broadly diversified: remember that I own, *in this purely hypothetical example*, shares in as many as five hundred different companies.

I regard the ownership of businesses whose dividends and share values may grow over time as something I want to continue for the rest of my life. That's because I believe the essential economic challenge my wife and I are going to face in a potentially decades-long retirement is the erosion of our purchasing power.

Each year, just about everything we need to buy will cost more, if history is any guide, and it's the only guide I've got. I'm hoping that, as they've tended to do over long periods of time in the past, the rising dividends and share values of superior businesses may help to offset our rising living costs. Since that is the experience I anticipate having, I don't regard owning portfolios of good businesses as something one stops altogether, or radically scales back, in retirement. Quite the contrary.

The fellow sitting next to me on the plane as I write may be invested in exactly the same portfolio as I've hypothesized myself owning, purely for the purposes of this essay. But let's say he characterizes that experience to himself as "being in the stock market." "The stock market" is a wild, volatile and often terrifying place. No question about it. Why, between October 2007 and March 2009, it went down by well over fifty percent, which my seatmate experienced as "the stock market losing over half its value." He may even have bailed completely out at that point.

Perversely, and seemingly against all reason and logic, "the stock market" then turned around on a dime, and soared over 80% from its lows in just a bit over thirteen months, without so much as a correction. I'm guessing that at some point my seatmate may ruefully have decided to "get back in the stock market."

Whereupon, driven by global fears of a financial meltdown in the eurozone and the greatest environmental disaster in US history, "the stock market" recently plunged nearly fourteen percent in just 45 days. Indeed, it quite savagely wiped out all its previous gains for the year 2010. I think it's just possible that my buddy, over here, is fixing to jump out of "the stock market" again, if this doesn't let up pretty soon. Moreover, I suspect that he regards the very idea of remaining in anything as risky as

“the stock market” in retirement as daylight madness.

One of the iconic advertising jingles of my lifetime—right up there with “I’d like to buy the world a Coke”—was that of a global food and consumer products company. It sang, “Everybody doesn’t like something, but nobody doesn’t like Sara Lee.” (In the current regulatory environment, I may need ritually to state that I make no representations about the financial condition or the business prospects of Sara Lee Corporation or The Coca-Cola Company, and do not recommend the purchase or sale of any of their securities, something I am neither licensed

nor even remotely competent to do.)

In exactly that sense: everybody doesn’t like “the stock market,” but nobody doesn’t like the great businesses in America and the world. Intellectually, the two concepts may represent substantially the same thing. But emotionally—where nearly all investors make nearly all their investment decisions—they are all but polar opposites. And the experience you end up having of them may be a very direct function of the words you use to conceptualize them—and what those words mean to you.

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