



AN INDEPENDENT FIRM

ECONOMIC UPDATE

*Individual Solutions
From Independent Advisors*

January 2011

HAPPY NEW YEAR!

As we begin 2011, many of us are eager to put the recent past as well as the last 10 years far behind us.

We continue to see a strong recovery in global investment markets following the recession and financial crisis we experienced in 2008 and early 2009. We find that people now are not as fearful about another market collapse of the magnitude we felt from October 2007 until March 2009. There is, however, an increased fear of not having enough income to retire as planned, or to retire at all. This is likely to be the biggest problem faced by baby boomers in the coming decades and is the subject of much discussion in the financial world today. More on this later in the letter.

Last year was a roller coaster with significant periods of increases and decreases, to a point where it looked like there would be no progress at all, until the last 3 or 4 months. By the year's end, the S&P 500 Index (an unmanaged index of 500 widely held stocks) was up 15%, coming on the heels of 2009's increase of 26%. There is still a lingering and healthy feeling, however, that we are not yet "out of the woods".

While consumers and businesses have adjusted quickly, government entities have not. This year is likely to be a watershed year for addressing systemic spending problems at various government levels. It will not be a pleasant process, but then again, it has been more unpleasant for the countries that have let things get even further out of control than we have.



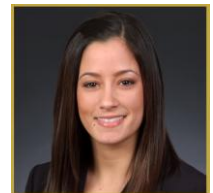
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Recently, the president has proposed a wage freeze for many federal workers, and as we wrote this letter, the new governor of New York has proposed a similar wage freeze for state workers there. Congress, just beginning the new session, has already had a proposal to reduce spending.....on running Congress!

In December, a presidential bipartisan commission released a comprehensive report of measures that needed to be taken to get our nation's financial house in order. We assume they were on the right track since other politicians from both parties raised quite a protest over some of the severe measures that will likely need to be taken. Among the issues were reduced spending in a wide variety of areas and adjustments to benefits in Social Security, including the eligibility age. This would entail a lot of shared sacrifice by the American people and my fellow baby boomers (the first one turned 65 on January 1st) have historically not been very good with sharing or sacrifice. With the federal government currently spending \$4 billion per day more than it takes in¹, something has got to give. Imagine spending even \$40 per day more than you make, for the next 20 (\$292,000) or 30 years (\$438,000), then passing that total debt on to your children or grandchildren to pay.

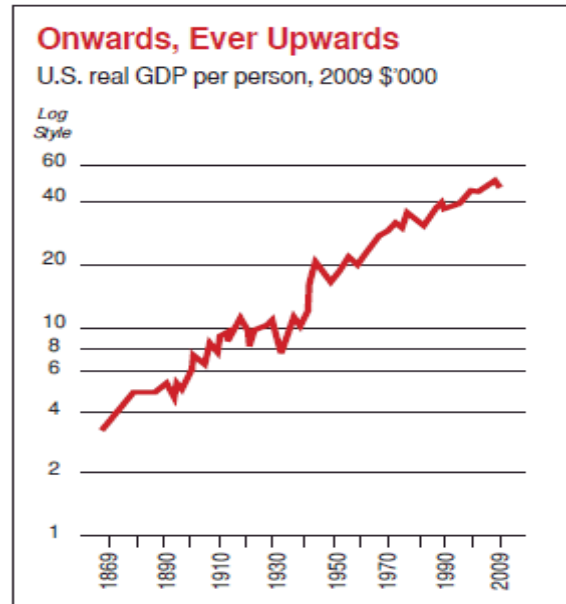
Despite what we will see from the political system in the coming year and beyond all of the headline noise, there is very substantial economic progress being made all over the world in many vital areas. There are a lot of examples, some very visible, others less so, but important nonetheless. Two such examples include:

- For the 3rd quarter of 2010, over 75% of S&P 500 companies beat earnings estimates and almost 60% also had increased sales. (Source: Zachs.com).
- As of year-end, consumer spending has now broken the previous record set in October 2007. Annualized consumer spending is now at \$9.4 trillion (US Commerce Dept). For the many people who felt the US consumer was dead, as Mark Twain once said, "the reports of my death are greatly exaggerated".

We are sure there will continue to be problems both in the US and around the world that have the potential to slow or even temporarily stop the current global expansion. We also believe that the really big problems, those the world faced in the autumn of 2008 and will continue to face, are being dealt with. That process will take a lot longer and be more painful than what any of us would like to see, but when a problem grows pretty much unabated for close to 25 years, fixing it is difficult and painful...but fixable.

There are those, including many in the media, still wringing their hands and feeling that the US and the world at large are in such bad financial condition that nothing will help. Several people have gotten far more of their "15 minutes of fame" by articulating this doomsday scenario on the cable shows. If there was any historical basis to support their worldview that would be one thing, but as English historian Thomas Babington stated: "on what principle is it that when we see nothing but improvement behind us, we are to expect nothing but deterioration before us." Winston Churchill said it even better: "the pessimist sees difficulty in every opportunity. The optimist sees opportunity in every difficulty".

Whether you look back at the history of the world and US economy or look forward after having survived the 2008 financial crisis, it is hard not to be optimistic about our future. The US has been (with few exceptions), in a permanent uptrend for over 200 years, and continues to lead the world in many categories including manufacturing (\$2.6 trillion, world's largest), education, and medicine.



Source: U.S. Department of Commerce; BLS; *The Economist*

The passage (for the next 2 years) of the continuation of the “Bush tax cuts” brought some sense of relief to the investment markets and certain provisions, such as the Social Security tax reduction will very likely result in both additional spending and savings. The social security tax reduction will save every worker 2% of gross wages to a maximum of \$2,136 for 2011.

We continue to hear about the record amounts of money (\$2 trillion) that are being held in reserve by US businesses. With a little more certainty and a recovering economy, we expect to see some of that money deployed in the future, which should enable the economy and employment to expand.

There is also an idea that we think has great merit, which, unfortunately, may mean it has no chance of becoming reality. Currently, US corporations, through foreign subsidiaries, have over \$1 trillion dollars² held outside the US. Perfectly legal, the money was made by those companies in their international divisions, but much of it is not brought back here because of the very high US corporate tax rates as compared to other countries. In 2004, there was a one year “tax holiday” offered to companies to bring the money back to the US, with a tax rate of 5.25%, compared to the regular rate of 35%. Needless to say, a lot of money came back. How about a similar plan, but tied to no taxes at all if the companies invest in training, hiring, or other expansion? If you think about it, it would cost the US nothing, since the money is not here anyway and probably is not coming anytime soon due to the tax burden.

At this time of year, there is no shortage of economic predictions for almost any financial or market measurement. Paul thinks he has read them all, though probably has missed a few along the way. Here are some of them:

- Dr. David Kelly, JP Morgan chief market strategist and our dinner speaker in 2009, sees the US economy growing at 4% per year, low inflation and low interest rates until 2012, and unemployment needing 5 more years to fully recover.

(Speaking of unemployment, we have read several times recently the disparity in unemployment rates based on education. For high school dropouts, the rate is over 15%, high school grads, 10% and college grads, 4.9%. Makes all those tuition payments seem worthwhile!)

- Dr. Stephen Wood, also one of our former dinner speakers and the chief market strategist for Russell Investments, is not quite so optimistic. He envisions an economy growing by 3.2% and predicts a less robust consumer. Longer term, he sees a lower standard of living as governments grapple with the enormous amount of debt they have incurred and inflation remaining at less than 3% for the next decade.
- David Kostin, from Goldman Sachs and the most accurate predictor of the S&P 500 performance in 2010 (Bloomberg), predicts a 15% rise in the S&P 500 for 2011.
- Bruce Kasman, chief economist at JP Morgan, feels that even with the somewhat disappointing employment news released on January 7th, that the economy will grow at a rate of 3.5 to 4.0% this year and that interest rates and inflation will remain low. He also believes that employment, particularly in healthcare, services and home construction will accelerate throughout the coming year, with unemployment falling to 9.0% by year end.
- Fed chairman Ben Bernanke, in remarks to Congress on the 7th, stated that there is “increased evidence that a self sustaining recovery in consumer and business spending may be taking hold” and that 2011 growth prospects appear to be better than 2010. He sees unemployment falling to 8.0% by the end of 2012. Not great, but an improvement.
- According to a poll taken by Bloomberg for the December 27th edition of BusinessWeek, the average of 11 leading economists predicted a 2011 finish for the S&P 500 of 1,374, which would make for the best 3 year return (over 54%) since the late 1990s.

The global story is similar. The International Monetary Fund expects the global economy to be \$65.4 trillion in 2011, up from \$62 trillion in 2010. In 2005 it was \$45 trillion and in 2012, projected to be almost \$70 trillion and over \$300 trillion by 2030. By the way, around 25% of that global economy is ours, with only 4% of the world's population. Clearly, the growth in emerging markets like China, India and Brazil are contributing greatly to this growth. In the US we had a period between 1950 and 1980 where our middle class blossomed. In the emerging countries, this same phenomenon began in the mid-1990's though with 10 times the number of people, according to economist Elizabeth O'Connor.

Despite what appears to be a growing consensus that the economic recovery will continue, there are some very big issues that we as individuals and as advisors need to focus on in the future. We know that we sound like a broken record on this topic, but we see the one “elephant in the living room” topic to be longevity and all that it entails, both good and bad.

The biggest issue is that people throughout the world are living longer and healthier lives and that trend is likely to continue. Longer retirements (maybe 30 years or more), more travel, time to pursue hobbies, and even second or third careers is something no other population in history has ever experienced. It is exciting and many of our clients are already at this stage or approaching it in the next few years.

There are challenges, however, and some big ones. How do we, as individuals and as a society, pay for this long lifespan, as old age comes at a high price?

Although the savings rate in the US has increased in the past few years, it is still far too low for most people to have a comfortable retirement. According to the Wall Street Journal, the average 401(k) balance for people in their 50's is \$139,000. To further exacerbate this problem, the amount of money withdrawn from stock mutual funds over the past two years (a period when the S&P 500 rose by over 30% and by over 70% from the March 9, 2009 bottom) was at record levels, according to Forbes.

The fear that drove people to abandon long held and successful strategies was both rational and irrational at the same time. The financial world did appear (at least to the media) to be coming to an end, but at the same time, any review of US economic or investment history shows one thing pretty clearly: an ever increasing upward trend for over 200 years.

Almost all of our clients remained invested and weathered the storm, but many people obviously did not and they have placed their retirement and perhaps any family financial legacy in serious jeopardy. If anyone who you know is in this position, we would be pleased to offer them our qualified “second opinion” on what they should do going forward to get back on track to achieve their goals.

Many people also felt that equity in their homes would help in retirement, but with home prices down 30%³ on average across the US (less here) that option has been removed, at least for the present time.

Long term care, unneeded when the life expectancy was only slightly longer than one's working years is now a major financial issue for many people. Insurance has been available, but many of those policies are now seeing significant premium increases. There are other options available that we'd be happy to discuss with you.

It is sad that at a time where people should be enjoying the benefits of a lifetime of work and investing, 61% of baby boomers now fear outliving their assets more than they fear death, according to a poll conducted by Allianz.

TRENDS

In an era of reduced expectations (interest yields on CDs, bonds, etc., below average economic growth) there are a few financial and investing trends that we see emerging that appear to be if not permanent, likely to be with us for some time.

The first is personal budgeting for retirement. With interest income low because of lower rates and little or no Social Security cost of living increases, reduced retirement account balances, less home equity, etc., people (including the very affluent) are watching spending more than we can ever recall with several public surveys confirming this trend.

Second, people are taking a far greater interest in economic events beyond the US, which is really good from a number of perspectives. Perhaps the most important is that we see no reluctance among clients who invest in stock or bond markets to commit some of that to foreign investments. Given that we believe that countries other than the US are likely to grow faster in coming years, this should help diversify both the returns and the risks of investing.

Third, people are seeking income and the investment firms are developing creative responses as the impact of low interest rates really affects the lifestyles of many retirees in particular. We have been researching available alternatives and feel we have developed several good ideas that taken together may successfully address this issue.

Fourth, there is more interest in insurance products than there has been for quite some time, with people desiring to have a portion of their money in areas that can provide guaranteed income, such as fixed annuities, for what they hope is a long life. Current interest rates reduce the attractiveness of these investments to some degree, but we see this development as a replacement for what used to be provided by pension plans. In 1980, 39% of the US workforce was covered by a traditional defined benefit pension plan. Today it is 15% and falling. Also, 22% of homeowners, 11 million people total, owe more in mortgages than their home is worth. Many are seniors.⁴

Life insurance costs are down, causing people to consider “refinancing” that coverage. There is also continued interest in people “selling” old and unneeded policies to third party investors (generally other insurance companies or institutional investors) rather than cancelling them through the issuing insurer. The market for this is primarily for people over age 65 with policies with over \$250,000 in death benefit. We have seen some significant additional cash value being received by selling rather than just cancelling the policy. With significant estate tax reform (only for 2 years, but likely to be permanent in some form) recently approved (federal exemption at \$5 million per person) there may be a lot of people considering cancelling policies that were going to be needed to pay taxes. If you have or know of someone who is in this situation, it is worth looking at the alternatives. Raymond James has selected a national firm to assist in evaluating these transactions and brokering the policy sale through a variety of funding sources.

NEWS AT EWS

Our thanks to all of our clients and their advisors for the faith and trust you have placed in us over the past year and also for what was, for us, a record number of introductions to clients' family members, business associates, and friends. We had a very busy year!

In order to continue to enhance and expand our client service, we have added a new member to the team, effective January 17th. Joanna Moore, who has over 15 years of experience working with several major financial services firms, was one of over 900 applicants we reviewed. During the interview process, we discovered that she once worked with a peer firm and a very close friend of Paul's. We are very pleased to have her join us. Joanna lives in Voorhees with her husband Glenn and three sons, Larry and twins Ben and Nicholas.

We have already arranged for this year's annual client dinner speaker and it is an exciting announcement to make. Jeff Saut, who is the Chief Investment Strategist for Raymond James in St. Petersburg, Florida, will be joining us in late September or early October (exact date and location to be determined shortly). Jeff is a 30+ year investment veteran (another baby boomer) who is, it seems, appearing on television or in the financial press almost every week. Maybe he should get his own show! He is credited with "calling" the bottom of the stock market in 2009 and is considered a true visionary in the global investment world. Paul met with Jeff last week in Tampa and found his outlook on the economy and investment markets to be one that clients will find fascinating and helpful. We will be giving you more information and updates on this event and on Jeff, but of all of our events, this is one you will not want to miss.

We have put on our website the "Raymond James 2011 Economic Preview". There are a number of very insightful interviews included that we think will be of interest to you.

Our best wishes to you, your family, friends and associates for a great 2011. If we can be of any assistance, please give us a call.

Best regards,

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Sources

¹Wall Street Journal.

²Hartford Investment.

³USA Today.

⁴BTN Research.

Disclosures

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Past performance may not be indicative of future results. You should discuss any tax or legal matters with the appropriate professional.

Investing in emerging markets can be riskier than investing in well-established foreign markets. Investing involves risk and investors may incur a profit or a loss, including the loss of all principal.

Fixed annuities are long-term investment vehicles designed for retirement purposes. Guarantees are based on the claims-paying ability of the issuing company. Withdrawals prior to age 59 ½ may be subject to a 10% federal tax penalty on the gains. Earnings are taxed as ordinary income upon withdrawal.

Life settlements are not suitable for every investor. There are fees and tax implications that should be considered. Consult a financial advisor to discuss all of the risks and costs involved with this type of investment prior to making a decision.